Philadelphia Estate Planning Council

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President's Message

Rebecca Rosenberger Smolen, Esq.

As suspected, this year has flown by. It's hard to believe it is already time to start thinking about the Summer and that my responsibilities as President will be behind me by the time the next issue of this newsletter is released.

I am happy to report that the Council remains in good shape and on a solid financial footing as we wrap up our luncheon series for this season and head to our Annual Meeting in May. Attendance at our luncheons has increased from the last few years, which I believe may be an indication that, with the rebounding economy, our members have experienced renewed engagement by clients in the estate planning process, and are eager to stay on top of important issues that arise in our work. At the same time, our membership numbers have been gradually decreasing, which seems to be largely attributable to retirements, relocations, and, sadly, some deaths. It is likely that over the next few years we will see our membership repopulated with newcomers to our field who will be needed to handle the workflow previously managed by our predecessors. In the meantime, due to the foresight of previous leaders of the Council, the gradual transition in the Council's funding structure to generate more revenue through our Platinum Sponsorship opportunities has allowed us to keep dues very low (we haven't had an increase in at least 5 years), without needing to make any sacrifices in the quality of our programming, despite the net membership attrition.

As I write this, I have just returned from our first Outreach Committee event at the beginning of April which involved a team of Council members working with volunteers throughout the city to participate in the Philly Cleanup Volunteer Day. Our project was to tend to a set of tree and flower beds along the Schuylkill Banks on a bright sunny day where we could finally feel like Spring is upon us. Next up will be our traditional Ethics program (after a hiatus last

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Estate Planning Opportunities as Interest Rates Rise (and While They're Still Low)

Kevin S. Koscil, Esq.

Interest rates are an important component of many tax efficient wealth transfer strategies. Some strategies work better in a low interest rate environment, such as the one we've enjoyed over the last several years, while others are more suitable when interest rates are high. As the Federal Reserve signals an upward trend in interest rates, it is a good time to examine the strategies that will become less and less effective, and those that will come to the fore. For deploying the strategies in the former category, now seems to be as good a time as we are likely to see for a while since rates still remain historically low.

Generally speaking, two interest rates are going to be important in this discussion: the Applicable Federal Rate ("AFR") and the rate prescribed by Section 7520 of the Internal Revenue Code (the "Section 7520" rate). The AFR is, among other things, the rate at which intra-family loans must bear interest to avoid implicating the gift tax regime; intra-family loans that do not bear adequate interest are deemed to be

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2015 ANNUAL GOLF AND TENNIS OUTING

Wednesday, June 10, 2015

Golf
Registration .... 10:30 a.m. - 12:00 p.m.

Lunch Buffet .... 11:15 a.m. - 12:30 p.m

Golf Tee Time............ 12:30 p.m.

Tennis
Round Robin .... 2:30 p.m. - 4:30 p.m.

Beginner's
Golf Clinic .... 3:00 p.m.

Roundtable
Program .... 4:00 p.m. - 5:30 p.m.

Reception
Cocktails
& Hors D'oeuvres ..... 6:00 p.m.

Dinner .... 7:00 p.m.

GOLF, LUNCH AND DINNER

Sunnybrook Golf Club
398 Stenton Avenue
Plymouth Meeting, PA 19462

TENNIS

Philadelphia Cricket Club
St. Martins Clubhouse
415 W. Willow Grove Avenue
Philadelphia, PA 19118

For information contact the PEPC Office at 856-234-0330 or staff@philaepc.org.

President's Message continued

year), yet another Drop-In Networking event, the Annual Meeting at the Philadelphia Art Museum, and then the very popular Golf & Tennis Outing at Sunnybrook Golf Club and Philadelphia Cricket Club in June (which tends to sell out, so, I suggest you sign up ASAP). The Outing will include another Roundtable session for those who would like to participate in the opportunity to mix and mingle with members, but not the athletic offerings.

We are still working on planning the inaugural Fall Outreach "Estate Planning Day" program on October 24th as part of National Estate Planning Awareness Week. We first planned to hold it at the Pennsylvania Convention Center, but, we later determined that the PBI Education Center at the Wanamaker Building would be a better fit. We have received a good deal of positive feedback and interest in this Estate Planning Day program from members, but, not surprisingly, there have been critics as well who seem to believe that the Council's resources should be focused only on internal programming, as, for the most part, has historically been the case.

The Board had a special meeting in April to discuss this issue. My perspective has been that this type of program, which has been encouraged by the National Association of Estate Planners & Councils, is, at minimum, a "threefer". First, it provides a public service by educating the public on important estate planning issues. At the same time, the program itself creates an opportunity for our members to initiate and further develop mutually beneficial working relationships within our membership ranks while engaging in professional development by organizing and presenting at seminars. Last, publicity for the program can help remind our clients and prospective clients to update or initiate their estate plans, so, it can provide a marketing function for the services offered by all of our members. Because the goal of the program is to benefit the Council membership as a whole, as opposed to generating publicity for specific members or organizations, the plan has been to fund the program solely from admission fees and the Council's general revenue derived from annual membership dues and fees paid by our Platinum Sponsors (instead of soliciting sponsors for the program as is our approach for most of our member focused programming).

Other planned components of the Outreach efforts include posting to our website "white papers" on estate planning topics geared to the public, and potentially to create a referral service for the public (although this aspect may alternatively be addressed by the self-service public directory of Council members).

It appears that our greatest challenge for the Estate Planning Day program may be to spread the word in our community to generate attendance. We will only have a moderate amount of resources in the budget for marketing the event. The Board considered but elected not to create a larger budget which could have supported a broad based "media buy" and the engagement of a professional public relations and marketing consultant. Accordingly, we will need to explore as many cost-free and minimal cost opportunities to spread the word as possible.

All ideas are welcome to help meet this challenge. I am pleased to report that one helpful idea I received from a colleague has already come to fruition – we received tentative confirmation that a message about the Estate Planning Day program will be posted, for free, the weekend leading up to Estate Planning Awareness Week on top of the PECO building as part of the PECO "crown lights" program.

Please let me know if you are able to be a liaison to any organizations or communities you are involved with that could provide an appropriate forum for spreading the word. For example, it would likely be fruitful to circulate a flyer (or its electronic equivalent) to residents at some of the larger condominiums in the city where a significant number of retirees or near retirees are living. Also, charities that encourage planned giving among their donors might be willing to share event information with them in a newsletter.

In closing, I want to express my sincere thanks to all of our members, board members, and sponsors, but, most importantly, to our hard-working and dedicated committee chairs and committee members, who have together made this a jam-packed year full of tremendous programming. For those of you who have sponsored an event, or served on one or more of the Council's committees, I hope you will continue your critical support for the Council. For those of you who haven't served the Council in these roles, please make an effort to do so next year so we can have an even better year together. Our high quality programming is only possible with the financial support from our sponsors coupled with the time and talent provided by our committee chairs and committee members. Have a great Summer everyone!

Interest Rates continued

disguised gifts to the extent of the interest rate discount. The Section 7520 rate is important for so-called split-interest transfers, which are discussed in more detail below.

This article discusses the effect of interest rate fluctuations on several tax efficient wealth transfer strategies, beginning with intra-family loans, followed by several varieties of split-interest transfers. It should be noted that this discussion necessarily does not analyze all of the elements of the strategies referenced; rather it seeks to highlight the way in which interest rates affect a few selected strategies and, by doing so, provide a framework for analyzing how interest rates will affect other strategies.

Intra-Family Loans

Intra-family loans perform better in low interest rate environments; thus, in light of current interest rate projections, this strategy is better implemented sooner, rather than later.

Perhaps the easiest way to take advantage of low interest rates from a wealth transfer standpoint is through use of a low-interest loan. This can take the form of a direct loan of cash to the intended beneficiary, in which case the borrower will invest the borrowed funds and any net investment return in excess of the interest rate paid to the lender will represent a gift and estate tax free transfer of wealth. In other cases, the beneficiary's promissory note is given as consideration in a sale of family assets, in which case the spread between the purchased asset's appreciation and the interest paid to the lender represents a gift and estate tax free transfer of wealth to the borrower. In either case, low interest rates mean a bigger spread. Because of the incentive, in the family context, to drive the interest rate ever lower, the IRS has placed a floor on the interest rate that may be charged without constituting a gift from the lender to the borrower in the form of foregone interest. That "floor" rate is the AFR. The IRS publishes monthly tables that provide the AFRs for short-term, mid-term, and long-term loans depending on the frequency of compounding (annual, semi-annual, quarterly, and monthly), and the AFRs move in sync with prevailing interest rates. All a planner must do is select the appropriate AFR from the table based on the desired terms of the loan.

Building on the intra-family loan concept, a sale to a grantor trust is a strategy with a similar exposure to interest rates. Use of a grantor trust is particularly beneficial in certain situations due to the fact that assets in a grantor trust are excluded from the grantor's estate, yet the assets are treated as owned by the grantor for income tax purposes. A grantor trust can be funded without the imposition of income or capital gains tax (on either the grantor or trust) because the grantor is treated for income tax purposes as retaining ownership of the assets. The trust could purchase assets from the grantor in exchange for a note, yet because the trust is disregarded as an entity separate from the grantor for income tax purposes, the interest payments will not be income to the grantor, nor would the grantor recognize gain on the sale of appreciated assets to the trust. Ideally the assets sold to the trust will produce income sufficient to service the note payments. Any excess income or appreciation is therefore transferred to the trust beneficiaries gift and estate tax free. The lower the interest rate on the note, the easier that desired outcome is to accomplish.

Split-Interest Transfers

When a donor transfers property in trust or otherwise and retains an interest in the transferred property, the value of the gift is generally the value of the property transferred less the value of the donor's retained interest. The retained interest reduces the value of the gift, which is of course beneficial for gift tax purposes. The general formula is expressed as follows:

FMV of property transferred – retained interest = remainder interest

This is what's known as a split-interest gift and, though there are variations, it is the general concept underlying many wealth transfer strategies, including the ones discussed below.

Certain techniques require a valuation of the retained interest. Others require a valuation of the remainder interest. In both cases, though, the variable that a planner must solve for must be discounted to present value and, for that, the Section 7520 rate is used. The Section 7520 rate equals 120% of the mid-term AFR for annual compounding, rounded to the nearest .2%. Since the AFR moves in sync with prevailing interest rates, so does the Section 7520 rate.

The following discusses four popular, and interest-rate-sensitive, split-interest gift techniques.

<u>Grantor Retained Annuity Trusts (GRATs)</u>

Grantor retained annuity trusts perform better in low interest rate environments. A GRAT is a trust to which the grantor transfers assets while retaining the right to an annuity for a term. This is a type of split-interest gift in that the transfer to the trust is a taxable gift to the trust beneficiaries, but only to the extent that the value of the assets transferred exceeds the present value of the retained annuity. As the presumed value of the annuity grows, the value of the taxable gift declines. The present value of an annuity is higher in a low interest rate environment (all other factors remaining constant). Thus, a

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Interest Rates continued

relatively low interest rate will lead to a relatively low taxable gift.

At a certain level, the value of the annuity will equal the value of the assets transferred into the trust, so there will be no taxable gift. In this situation, the GRAT will be considered "zeroed out." This is easier to accomplish when the interest rate used for discounting the annuity to present value is low.

Ideally, the assets transferred into the trust will retain value and produce sufficient income such that (a) the trustee can satisfy the annuity payments, and (b) assets will remain in the trust at the conclusion of the annuity term. The rule of thumb is that if the net rate of return inside the trust exceeds the Section 7520 rate in effect when the GRAT is established, some assets will remain for the trust beneficiaries after the annuity stream has been fully paid out. In this respect, the Section 7520 rate is a hurdle rate and, as such, lower is always better.

The Section 7520 rate for May 2015 is 1.8%, which is low for a hurdle rate. As rates increase, GRATs will become less attractive.

<u>Qualified Personal Residence Trusts (QPRTs)</u>

The converse to the GRAT's preference for low interest rates is the Qualified Personal Residence Trust's preference for high interest rates. A QPRT is a trust into which a grantor transfers a primary home or vacation home while retaining the right to live in the home for a term of years. At the end of the term, if the grantor is alive, the home will pass free from any further gift and estate tax liability to the beneficiaries of the QPRT either outright, or in further trust. If the grantor does not survive the term of the trust, the home will be pulled back into the grantor's estate.

A QPRT is another variation of a split-interest gift. When the QPRT is established, the gift to the trust beneficiaries is measured by the fair market value of the home minus the actuarial value of the grantor's retained interest, i.e. the right to live in the home during the term of the trust.

More specifically, the Treasury Regulations provide that the present value of an interest that will take effect after a definite number of years or after the death of one individual is computed by multiplying the value of the property by the appropriate remainder interest actuarial factor (that corresponds to the applicable Section 7520 rate and remainder interest period). Treas. Reg. § 25.2512-5(d)(2)(ii).

The referenced remainder interest factors are found in a table published by the IRS. The factors are a function of the Section 7520 rate and the term, and the factors decrease as the Section 7520 rate increases. This means that the present value of the remainder interest (i.e. FMV of property transferred *multiplied by* the remainder interest factor) will be *less* in a high-interest-rate environment. This makes sense conceptually as the present value of a future sum is always relatively low when the assumed interest rate is relatively high (all other factors being constant).

Because a QPRT is more effective when the remainder interest is ascribed a low present value, a high interest rate is preferable so that the discount to present value will be sharper. This is a theme that can be applied to other strategies as well.

<u>Charitable Lead Annuity Trusts (CLATs)</u>

Charitable Lead Annuity Trusts, like their distant cousin the GRAT, perform better when interest rates are low. A CLAT is a trust structured to pay set amounts to a charitable beneficiary for a term of years, with the remainder paid to (or held in further trust for) a noncharitable beneficiary. Mechanically, a CLAT is very similar to a GRAT in that the value of the annuity stream is subtracted from the value of the assets transferred into the trust in determining the value of the taxable gift to the remainder beneficiaries. With a CLAT, the annuity stream is paid to a charity, so, in addition to reducing the value of the taxable gift, it also generates an immediate income tax deduction. Obviously, then, a CLAT will work best when the value of the charitable annuity is high.

The present value of the annuity is determined by multiplying the annuity payment by an "annuity factor." The annuity factors are found in IRS tables and are functions of interest rates. As interest rates rise, the annuity factors decrease. As the annuity factor decreases, the present value of the annuity decreases as well. This makes sense conceptually as the present value of an annuity (or any future sum for that matter) is always relatively high when the assumed interest rate is relatively low (all other factors being constant). In any case, rising interest rates, which cause lower annuity values, mean lower charitable deductions for grantors. When interest rates are relatively low, the present value of the annuity stream, i.e. the deduction, will be relatively high as the discount to present value will not be as sharp.

Unlike a GRAT, a CLAT can be established as a testamentary trust, in which case, the remainder interest is subject to estate tax in the grantor's estate. In either case (lifetime gift or testamentary trust), the value of the annuity stream is a deduction against either the total gifts or the total gross estate, as applicable.

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Charitable Remainder Annuity Trusts (CRATs)

A Charitable Remainder Annuity Trust is a trust structured to pay a fixed annuity amount to a noncharitable beneficiary for a term of years, with the remainder paid to a charity or charities. It is essentially the reverse of a CLAT and, as such, the CRAT works well when interest rates are high.

In the CRAT context, the actuarial value of the remainder interest, which is paid to a charity or charities, is deductible for income tax purposes as well as estate and gift tax purposes. A higher remainder interest, then, is more beneficial. Per the Treasury Regulations, the present value of the charitable remainder interest, i.e. the deduction, is determined by subtracting the present value of the annuity from the fair market value of the property or cash transferred to the trust.

Thus, the lower the present value of the annuity, the larger the deduction. The present value of the annuity is determined by multiplying an "annuity factor" by the annuity payment. The annuity factors are found in IRS tables and are functions of interest rates. As interest rates rise, the annuity factors decrease. This makes sense conceptually as the present value of an annuity (or any future sum for that matter) is always relatively low when the assumed interest rate is relatively high (all other factors being constant).

Rising interest rates, which cause lower annuity values, mean larger remainders and, therefore, larger deductions.

Conclusion

Intra-family loans, GRATs and CLATs are still well situated to take advantage of the current, low interest rate environment while it lasts. As interest rates continue their long-awaited climb, CRATs and QPRTs may logically become more popular as will any other strategy that follows a similar blueprint.

Kevin Koscil is an attorney at White and Williams LLP, where he focuses his practice on estate and trust planning and advises on a broad range of corporate tax matters involving businesses and their owners

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Buying Life Insurance on Children - A Good Idea for the Future, or the Unthinkable?

Ronald I. Woodmansee, CLU, CEBS, MSFS

There are varying thoughts regarding the idea of insuring or not insuring children, particularly young children. Although there is probably no absolute right or wrong answer to the question, there certainly are pros and cons in doing so. In my thirty plus years in this business, I have often debated in my own mind whether or not to bring up this topic with clients, and have therefore never really pushed the issue very hard with most of them. However, recent happenings have caused me to rethink this concept and it merits some discussion.

Many times when the topic of insuring children is discussed, parents get emotionally turned off and seemingly do not want to admit that a premature death of a child is ever a possibility. After all, is there an actual financial loss from the death of a child? This is similar to the topic of wills when speaking to a client about his or her final thoughts. Many times I find it easier to get a check for a life insurance policy than to get a client to speak to an attorney to draft a will.

While it is true that, except for possible extenuating circumstances in very wealthy families, a true and direct large financial loss from the death of a child is not likely. However, you must also consider the emotional and financial impact on the parents. For example, if a parent is unable to function in the near term at work, would he or she have the same level of income continuing if substantial time is missed at work, due to the obvious emotional stress? Someone who works for a larger company may be given more available time and resources than someone who is self employed, and is therefore dependent upon his or her time to produce family income.

There will always be a final expense cost regardless, and this fact is often overlooked. I personally watched my assistant borrow from her 401(K) to bury her 19 year old son who died suddenly in 2006. The sad part about that painful tragedy was that she did have a small burial expense policy on him at a young age, but unfortunately dropped it during a period of financial strife.

Although the resulting loss of income could be argued either way, the issue that is most often not thought about by the parents, and perhaps is misunderstood and neglected by many, is the issue of future insurability. Future insurability means the ability to get life insurance coverage much later in life, without any medical underwriting, and regardless of any changes in health.

I recently gave a good long term client the complete authority to reprimand me for not having recommended this concept to him for his children years ago. This client and his wife have been well insured with me for a number of years. A few years ago, his daughter, then in her early twenties, was diagnosed with Non Hodgkin's lymphoma. Although she has been cured, she still will not be able to get life insurance issued on a standard basis for a few more years. In the past year, his son who is in graduate school was just diagnosed with testicular cancer. Thankfully they have been cured and each is on the mend. The son recently became engaged but unfortunately it will be a few years before he will be able to get any type of life insurance coverage on a favorable rate basis. When I told the client to reprimand me he admitted that, although he and his wife actually thought on their own in the past about insuring their kids, for whatever reason they chose not to pursue it. Perhaps with my advice and counsel, which they have always taken, things would have been different in this case.

There are many things that could happen to a child from the early years through adulthood, any one of which could render a person uninsurable at any time, sometimes suddenly, and sometimes gradually. Some of those risks are readily

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January Luncheon Program

Meeting sponsor Donald Braun, Bernstein Global Wealth Management with PEPC President Rebecca Rosenberger Smolen and speaker Brian Wodar

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understood and are somewhat common while others may not be. You might therefore ask what could affect a child later on in life that would make him or her uninsurable. Consider the possibilities.

Certainly there are the most evident risks such as a childhood sickness or a tragic accident which, although not resulting in immediate death, could result in a person's reduced mortality and therefore impaired insurability. This could be from a car or bike accident, a sports injury, or simply from horseplay. These are the most obvious ones, but there are others.

Obesity and Type II diabetes in this country are becoming more and more common. Although many cases can be controlled by diet, exercise and/or medication, this does not always mean a life insurance policy will be issued at standard or preferred rates. I recently interacted with a 40 year old client who is not taking care of himself, but who needs additional insurance. However, he declined a rated (extra premium) and much needed policy which was underwritten but cost 50% more due to his elevated A1C levels in his blood. He does have one $100,000 future guaranteed purchase option left on an old policy that his dad purchased at age 21, but that is not until 15 months from now.

There are also issues that certainly affect insurability, but may not become apparent until kids hit their teens. These include issues like addiction to alcohol or drugs, and/or severe mental illness. Unfortunately, these conditions are becoming more and more prevalent in today's society and in many cases will render these people uninsurable later in life. The client may also have a child that joins the military. Policies are not generally issued to people in the military that are deployed or soon to be deployed. These are just some of the events that can happen later in life that would affect someone from being able to purchase life insurance on a favorable basis if, at all.

For many of the above reasons, if a client can and does really want to think on a truly long term basis, it may make sense to consider buying policies on his or her children. Generally this is done with permanent policies and not term insurance. They typically cost just a few hundred dollars apiece per year. Most importantly for the future, these policies offer what is generally called a guaranteed insurability option (GIO) which allows the insured or owner to purchase additional coverage at specified future dates. These options usually start at age 25 and occur every three years until age 40, or sometimes even through age 46. This feature will give the insured up to 8 different option dates during which he or she can purchase additional coverage, regardless of health. Additionally, the coverage will be issued at the same rating class at which the policy was initially issued. Policies for those under age 17 would generally automatically be issued at a standard rating class instead of a preferred class. Insureds over age 17 may be able to get the most commonly issued second best class, or even the top rating class of that particular carrier, based on normal underwriting criteria.

The amount of these GIO options vary by company but generally can be up to $100,000 or $125,000 per option, although the option amount is many times a function of the base benefit (with 2 x the base being common). This means that a young person can be issued a small policy, perhaps in the $50,000 to $100,000 range, and have the guaranteed ability to get up to $1 million dollars more in the future, all at standard rates. I did this for my own children as soon as I could, which was 14 days after birth. I am sure that some underwriter in 1988 had a good chuckle when I listed the duties of a newborn as eating, crying, etc. Now each of my kids has the guaranteed ability to get over $1 million dollars of additional coverage in the future. I am so glad I did so as it appears that at least one of them, if not two, may have some issues preventing them from getting standard coverage without the guaranteed option to do so.

One of the valuable features of the GIO option is that a person can take an early option at marriage or at the birth of a child and in lieu of the upcoming option. So, if my client's son mentioned above who just had testicular cancer got married at age 23, he could take the option at age 25 early, with the next one occurring at age 28. Of course, a person can take all or none of the options in the future. There is no penalty for

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February Luncheon Program

Sponsor Sean Skelly, Speaker Gideon Rothschild, PEPC President Rebecca Rosenberger Smolen, Sponsors John Sabino and Anton Hammock from Capital One

Children continued

not taking any of the options, but they are not cumulative if skipped when they come due.

Another unique option on a policy on a child that also should be considered, although some times this is debated, even on policies for adults, is the waiver of premium benefit for disability. This benefit is extremely inexpensive, literally costing no more than a few dollars per year. If that benefit is added to the original policy and the insured should then become disabled later in life, the waiver of premium feature actually purchases the additional GIO options as they come due, and with no premium payment required. The premium is "waived", meaning paid for by the insurance company, by virtue of the waiver of premium benefit. This means that all increases in cash values and death benefits continue as long as the insured is disabled. More importantly, the in force coverage is maintained and increased, and at no additional out of pocket cost to the insured or policy owner.

Because these policies are permanent in nature, they develop the typical tax deferred cash accumulation that any life permanent policy accrues over time. Some advisors, and also some advertisers that I have seen on TV, recommend these policies as a way to accumulate additional funds for college. Although any funds saved for college are better than none, I am not convinced that recommending policies on children for that purpose makes as much sense when compared to other preferred college savings vehicles. This is partly due to the fact that clients are not usually spending large amounts of premium on these policies for children and therefore not likely to have substantial cash accumulations by the time the child goes to college. There are also other reasons why this is certainly not the preferred vehicle for college savings. However, that having been said, I did have a teaching moment and a life lesson for my oldest son about three years ago.

Because he spent far too much time, and far too much of my hard earned dollars trying to get out of college, I finally decided that at one point that his last year of college would be on his dime. Because he abruptly returned from college overseas to re-enroll here, he did not have enough time to acquire a student loan in his name. I reminded him that he had a life insurance policy that I had originally taken out at his birth, into which I had paid about $600 a year in premiums, and which then had over $21,000 in cash accumulation. I sat down and told him that this policy some day would be his, but in the meantime we could make a phone call and borrow some of this money early to make the tuition payment that

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Children continued

was now due. He was amazed and asked if he could really do that with a life insurance policy. I told him that we could do so and that if he did not pay the loan back he was only going to hurt himself later because this would eventually be his own policy. When he did finally graduate and became employed soon after, he started to pay back the loan on an automatic deduction from his checking account and has been doing so ever since. Again, the cash accumulation is a secondary benefit of these small policies and, although not designed for that purpose, it is a feature not to be overlooked.

One logical question on insuring children might be whether or not the same goal can be met by using a term policy instead of a permanent one. The answer is yes and no. Many companies have restrictions on issuing term policies at really young ages, but they can certainly be issued for kids in their teenage years and above. The good part about a term policy is that the cost is extremely low relative to the value of the death benefit in the early years. The downside is that the rate guarantee with any term policy will expire, typically in ten or twenty years, immediately after which the rates increase by a factor of ten and then exponentially every year thereafter.

However, the real downside of issuing a term policy on children is that, with the possible exception of what are called "jumping juvenile" term policies (which I admittedly sold during the summers in college), there is no GIO availability on any term insurance policies. The insured always has that amount of coverage in force and that coverage can easily be converted to permanent coverage in the future, and without medical underwriting. However, if the person's health changes, there is no guarantee with a term policy to be able to increase it in the future.

Ironically, I received a call from a client of mine a few months ago who inquired about getting small term policies on the lives of his college age children, simply to cover the amount of student loans that were in place. It was a very noble and conscientious thing to do. When the loans are repaid, they can either decide to let the policies go or maybe keep them for future needs. They can also consider converting them to permanent coverage later if they are so inclined.

Again, there is no right or wrong answer on the concept of insuring children. One way of looking at the issue is that there is very little down side in doing so. Sometimes these policies are relatively small, especially compared to larger needs as the child ages. Therefore they can be perhaps less efficient regarding costs and price breakpoints, particularly if initially purchased only for final expenses. I have seen a few of the $10,000 policies that were issued on a child 20 or more years ago, and that child is now in his or her 40's or 50's. Then the question becomes what do you do with a $10,000 policy at that age?

If the policy is with a good carrier, and a good performing product, and with perhaps ability to pay for itself forever and without future premium payments, then I generally recommend that the insured keep the policy. On the other hand, if the cash value of the policy is equal to or close to the face amount, so the policy is really not insurance at this point, then the client can, and perhaps should, take the money and run. In all likelihood the client can do something more efficient with those dollars.

As an alternative the client could always donate the policy to charity as another option, which would give him or her a tax deductible contribution. Either way, none of these options is really a bad one. Therefore, even the smallest of policies issued in the child's early years may be okay later in life. However, when initially purchasing the policy for a child, consideration should be give to the initial size of the face amount, taking into account the amount of the available GIO, the long term efficiency of smaller policies, etc.

Without such a policy, if something happens to the child later in life, he or she may be forced to do without the needed insurance, or may have to spend more money than an otherwise healthy person would spend to get it. So, for those who have the means to do so, and can think out beyond a ten or twenty year time horizon, there really is nothing to lose.

Ronald I. Woodmansee, CLU, CEBS, MSFS - Woody is the principal owner of Woodmansee & Company. The firm focuses in two primary areas, life and disability income insurance for personal and business needs and employee benefit plans for small companies.

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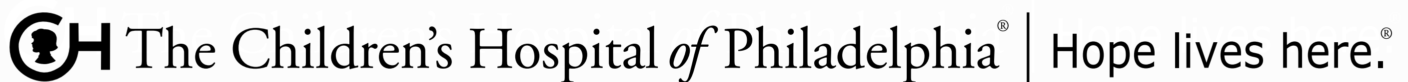

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Estate of Elkins, Jr. v. Comm'r – Great News for Art Collectors?

Alan J. Mittelman, Esq.

The U.S. Court of Appeals for the 5th Circuit just turned the art world upside down with its recent decision in the *Elkins* case (Estate of Elkins, Jr. v. Comm'r, 767 F.3d 443 (5th Cir., 2014)). In this case, the estate appealed a tax court decision which awarded a 10% discount for fractional shares of art bequeathed to the decedent's children. The estate had claimed that there should be a 44.75% discount on tenant-in-common interests in a number of art works owned by the decedent and the IRS had argued for a zero discount. The appellate court did side with the estate and determined that the discounts (lack of marketability and lack of control) should be about 50%, even more than the estate had originally requested.

This result is unheard of in art planning. For nearly 50 years since Rev. Rul. 57-293, the IRS has taken the position that there was no discount of fractional share gifts of art to museums. This has been a boon for art collectors willing to make gifts of their art to museums. The collector could give a partial interest (e.g., 10% tenant-in-common interest) in the art to a museum and take a deduction for 10% of the fair market value of the work of art without any discount being applied.

The "no discount" approach for valuing gifts of art is entirely different than nearly any other form of fractional share ownership interest. For example a tenant-in-common gift of real estate can be discounted by 15% to 40% depending upon the facts and circumstances. And gifts of limited partnership interests and gifts of minority interests or non-voting interests in businesses commonly are heavily discounted with the amount of the discount depending primarily on the underlying assets of the entity. Discounts of gifts of ownership interests in entities that own real estate tend to be greater than gifts in entities that own mostly marketable securities. Even as the IRS has continued to challenge the amount of discount that is appropriate for a gift of a fractional share of an asset or a limited partnership interest, a "safe harbor" of sorts exists for discounts that are the equivalent to the discount for tenant-in-common interests.

In fact, one can state that the discounts for fractional share gifts are the backbone of many of the most important estate planning concepts used today. Such discounts are key to strategies that use QPRTs (qualified personal residence trusts), gifts of family limited partnership or family limited liability company (LLC) interests, sales to grantor trusts and tenant-in-common ownership with children. But until now, the kinds of discounts used with these estate planning techniques were not available for gifts of art within one's family. So what happened?

First, let's look at a little history. In the *Stone* case (*Stone v. U.S,* 103 A.F.T.R.2d 2009-1379 (9th Cir. 2009)) the 9th Circuit court of appeals held that the decedent only was entitled to a 5% discount on a 50% interest in an art collection. The estate had claimed a 44% discount. The IRS being ever consistent countered that there is no discount for a fractional interest in art. In this case, the taxpayer was not able to present any evidence to show there ever were discounts for purchases of partial interests in art. However, the court did acknowledge that there might be some attorneys' fees and selling costs to sell or partition the art.

This is exactly where things stood until the *Elkins* case. In *Elkins*, the tax court basically agreed with the *Stone* court when it ruled that the estate only should have a 10% discount on the partial interest it owned in its art collection. The estate had requested a 44.75% discount on fractional interests in art

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Art Collectors continued

and the IRS had denied any discount. The estate appealed and as noted above, the 5th Circuit Court of Appeals held that the estate should be entitled to an even higher discount of nearly 50%. A resounding victory for the estate and a huge loss for the IRS.

Let's review some of the facts to see what the *Elkins* estate did correctly and try to understand this case's impact on planning for art collectors.

Elkins Facts – Mr. and Mrs. Elkins owned a substantial art collection. During their lifetimes in 1990, Mr. and Mrs. Elkins each created grantor retained income trusts (GRITs) that would last for 10 years. They funded their respective trusts with 50% undivided interests (tenant-in-common interests) in three valuable works of art. The retained right of each grantor was the "use" of the transferred art (instead of a dollar payment as is typical of GRITs and GRATs). At the end of the GRIT term, the art would pass in equal shares to their three children. Mr. and Mrs. Elkins held all of their other art collection as tenants-in-common.

The GRITS - Mrs. Elkins died before the 10 year GRIT term expired and in accordance with the terms of her GRIT, the three paintings passed to Mr. Elkins. Mr. Elkins outlived his GRIT and the art from his GRIT passed to his three children. After his GRIT ended, Mr. Elkins owned 50% of each artwork and his children each owned 16.67% of each artwork.

Then Mr. Elkins arranged for the children to lease back to him their 50% combined interests in two of the paintings. The lease was a year-to-year lease that would renew automatically unless terminated by Mr. Elkins. As part of the lease, Mr. Elkins and his children agreed not to separately sell or assign their partial interests in the art.

The Tenant-in-Common Art – Mr. and Mrs. Elkins also owned a substantial amount of other art. They owned this art as tenants-in-common. When Mrs. Elkins died, her will left this part of the collection outright to Mr. Elkins. However, instead of accepting his wife's entire 50% interest, Mr. Elkins disclaimed a 26.945% interest in each of the artworks (The disclaimer was to take advantage of Mrs. Elkins unused estate tax exemption at her death). The net result of the disclaimer was that Mr. Elkins now owned 73.055% of each of the other artworks and each child owned 8.98167% of each of the other artworks. Then Mr. Elkins and the children executed a co-tenancy agreement under which each owner had the right to possess and control each of the artworks for the total number of days each year equal to his or her percentage ownership. Furthermore, the artworks only could be sold with the unanimous consent of all the co-tenants.

And this is how things remained for ALL of the artwork until Mr. Elkins died.

At his death, Mr. Elkins left his undivided fractional ownership interest in his art to his children, in equal shares. His estate valued his entire art collection at about $12 Million. The value was determined by obtaining appraisals from Sotheby's and then applying a 44.75% combined fractional interest discount for lack of control and lack of marketability to the appraised values. This is the common method of valuing fractional shares of real estate and business interests. The IRS contended that the estate was not entitled to any discount. The value according to the IRS was about $23 Million.

In the appeals court, the estate experts testified that an even higher discount was appropriate and the IRS reiterated its position that there was no discount. The IRS did not offer any evidence on valuation. The IRS experts gave no ground on any rational basis for giving a discount off the value of art no matter how it was titled.

The appeals court disagreed with the IRS, beginning its analysis by stating that there should be a discount for a fractional interest in art. And since the IRS offered no evidence regarding the magnitude of the discounts and the estate was the only party that submitted any evidence on this issue, the 5th Circuit held that the IRS was barred from challenging the sufficiency or weight of the evidence on appeal. The Court held that the estate should get a 50% discount on its undivided interest in the art.

What Does It All Mean? There are a number of conclusions one can draw from the *Elkins* case. First, this result is now the law in the 5th Circuit. In that Circuit (Louisiana, Mississippi and Texas) taxpayers should now have many more planning opportunities to pass art to their families. They will be able to get substantial discounts when valuing fractional shares of art for lifetime gifts or at death. Some of the standard estate planning tools which often rely upon discounts to work may now work for art planning. Family partnerships or family LLCs that own art may now be used. New possibilities may now exist for the sales to grantor trusts. Estate planners can now get very creative when planning how to pass art from one generation to the next. And certainly tenant-in-common ownership with restrictions on sale will work.

However, it is not clear that taxpayers living in other tax circuits will fare equally as well. Taxpayers living in the 9th Circuit (California and the western states) presumably are still controlled by the holding in the 9th Circuit holding in the *Stone* case- a 5% discount of fractional interests in art. And

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taxpayers in all other jurisdictions may still find the IRS still taking the position that there is no discount for fractional interests in art. Pennsylvania and New Jersey are in the 3rd Circuit.

Second, the IRS lost so badly in *Elkins* because it submitted no evidence of how much discount there should be for a fractional interest in art. If the IRS had submitted any evidence at all and their experts testified that there should be some discount (e.g., 15% or 20%), it is very possible the 5th Circuit court would have agreed with the IRS and not the estate.

Third, taxpayers who have been making fractional share gifts of art to museums may wind up getting lower tax deductions for their gifts if the IRS agrees with the 5th Circuit when valuing fractional share gifts of art to a museum. If the IRS decides that the 5th Circuit was correct and that fractional interests in art should be discounted, then taxpayers may lose a substantial portion of the tax deduction in the future.

If the *Elkins* result is applied to fractional interest gifts of art to museums, then such donors will lose 50% of their tax deductions. IRS §170(o) which deals with fractional gifts of art to charities already was onerous. One of the unintended results of *Elkins* could be the end of fractional share gifts of art to charities. That would be a pity.

As a result of *Elkins*, there is now a state of confusion for estate planning for art collections. One hopes that the IRS will issue a ruling on the question to clear up some uncertainty. One would expect that there will be a number of new tax cases as a result of the *Elkins* case. Overall, it is an excellent result for taxpayers.

Alan J. Mittelman, Esq. is a member of and Chair of the Trusts and Estates Dept. of Spector Gadon & Rosen, P.C. in Philadelphia and Florida. His practice concentration is estate planning, trusts, estate administration, charitable giving, family partnerships and closely-held businesses.

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A Current Perspective on Life Insurance

J.R. Burke,CLU,ChFC,CFP®

Life Insurance in a Rising Tax Environment - As Planning Priorities Shift and Tax Rates Increase, Life Insurance Remains an Effective Solution

Advisors and successful individuals with federal estate tax exposure have long relied upon life insurance as a sophisticated planning tool. Life insurance offers a unique combination of instant liquidity, leverage and flexibility and is frequently utilized to fund future estate obligations.

Now, as effective income tax rates continue to rise, the unique lifetime features of life insurance, specifically its income tax treatment, become increasingly appealing. Life insurance is purchased with after-tax dollars, and the gain on its inside buildup is not taxed when held within the contract consistent with treatment of appreciation on stock or home.

Both High Net Worth and High Income taxpayers have been subject to substantial income tax increases in recent years. The cumulative impact of federal income, investment and payroll tax hikes significantly increases the tax burden of these top-bracket taxpayers. The cash accumulation features within permanent policies may produce more favorable long term results relative to other financial alternatives and should also be considered in the context of life insurance and financial planning.

Properly structured cash value life insurance provides the following unique tax characteristics, resulting in a product with significant planning flexibility:

- Interest credited to the policy's cash value is generally tax-deferred.[1]
- In policies with investment options a reallocation of the cash values does not create recognition of any gains in the policy.
- Policy cash value can be accessed on a first-in-first-out (FIFO) basis, using policy loans and withdrawals, allowing contributions to be withdrawn first, followed by gains.[2]
- The death benefit can be structured to be received income tax free to beneficiaries, pursuant to IRC Sec. 101(a)(1).
- There are no contribution limits (aside from complying with Section 7702 Definition of Life Insurance tests), income restrictions, or deduction phase-outs on life insurance premiums, a solution for clients who have already contributed the maximum allowable amounts to tax-preferential retirement accounts.
- Life insurance can be funded with earned or unearned income, creating planning opportunities using premium dollars from multiple sources.
- Life insurance can be owned by corporations, increasing its attractiveness in executive benefit plans and compensation planning. Businesses of all sizes can utilize the benefits of life insurance, including the tax-deferred cash value growth.

For situations that are not worried about the payment of estate taxes life insurance can still play an interesting role. The death benefits can be designed as a fixed amount and can be structured to avoid some of the volatility of returns associated with market-driven financial assets and planning techniques. Life insurance can be thought of as an asset class with little to no correlation with other asset classes, subject to the claims paying ability of the insurer. For example, a life insurance policy designed to offer a guaranteed level death benefit can be expected to provide this benefit regardless of economic conditions and does not have to rely on out-performing hurdle rates to be successful.

Summary - Due to a unique combination of tax advantages on both the accumulation and distribution of funds within it, cash value life insurance can be a powerful way to reduce income taxes over the long term. In addition, unlike the alternative retirement vehicles, life insurance benefits can be structured to pass to heirs without being subject to income or estate taxes, a feature that is exceptionally attractive to taxpayers with assets that are likely to exceed their lifetime needs.

Some comments and concerns on Indexed Universal Life Insurance

Over the last few years Indexed Universal Life Insurance (IUL) has become the most frequently sold permanent life insurance product. IUL allows the owner to allocate cash value amounts to either a fixed account or an equity index account. Policies offer a variety of well-known indexes such as the S&P 500 or the Nasdaq 100. Note that the policy doesn't actually invest in the index as does happen in an Index Separate Account inside a Variable Universal Life policy. Rather the insurance company tracks the index and credits the index's return to the policy.

There are many moving parts. Changes in the index can be credited on a monthly, yearly or multi-year basis. The gains from the index are credited to the policy based on a percentage rate, referred to as the "participation rate". It can be anywhere from 25% to more than 100%. There is also a "Cap rate" or a maximum amount of the change in

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the index that is credited to the policy. Both rates are set by the insurance company and can be changed (increased or decreased) in the future. Furthermore, the dividends earned by the associated index are not credited to the return.

The main attractiveness of IUL is that, if the index goes down, the loss is not credited to the account. Unlike Variable Universal Life there are no negative policy years. The insurance company is able to do this because they use part of the premiums to buy hedging contracts.

A thorough analysis of IUL is not the purpose of this article, but I'd like to point out the following concerns that some insurance commentators and professionals have with the product:

1. It is frequently marketed as a lower cost solution because the illustrations are based on historical index crediting rates that don't include any negative years. However, when an analysis is done of the internal charges against the cash value for policy expenses and the cost of insurance, it is frequently a more expensive "chassis". It is important to remember that the premiums are projected and can be changed in the future.
2. It may not, over the long term, outperform Variable Universal Life or Universal Life when and if interest rates increase.
3. It is difficult for clients to understand the different moving parts and there is a concern that they will not remember their understanding of it.
4. The fact that the index crediting rate does not include the dividends has always been pointed as a drawback. However, we have since learned that the hedges are discounted because of that, so it is already reflected in the pricing and performance.
5. A personal observation is that, after close to 40 years in the insurance business, I just have not seen a history of life insurance companies and Wall Street cooperating with each other over the long run. There is concern that the product is so dependent on the availability and pricing of the index hedges.
6. Insurance companies naturally go through changes in the Executive Suite as well as mergers and acquisitions. Will the future managers of the company maintain the current Participation and Cap rates?
7. Changes in the assumptions used to produce an illustration can produce very different results. In this regard, an insurance consultant has shared with me a series of Monte Carlo[3] simulations in which, at the illustrated premium and a 12% Cap, only 20% of trials lasted to age 100 – and the earliest lapse was at age 85; he dropped the Cap to 10% and only 1% of trials lasted to age 100; he increased the premium by 34% and then 91% of trials lasted to age 100. This is substantial volatility.

Summary - We do feel that IUL can have a place in a diversified insurance portfolio, but not as the foundation policy or the only policy. In addition there are a select few companies that offer an index account as an investment choice in a Variable Universal Life policy. Thus, if the policyowner no longer wishes to have an IUL-type policy, or a portion of the premiums and cash value allocated to an indexed account, a change in the allocations of the future premiums and current cash values is all that needs to be done – a new policy does not need to be purchased and no new underwriting is required. This may be a more prudent way to use the product, and is an alternative that should be explored.

J.R. Burke is the Founding Principal of Perspective Financial Group LLC, located in Berwyn, Pa. Mr. Burke is a Board Member of the Philadelphia Estate Planning Council.

1 Non-MEC policy gains may become taxable upon withdrawal, surrender, or lapse.

2 Subject to the rules and regulations of IRC Section 7702; policy withdrawals, loans, and loan interest will reduce policy values and may reduce benefits.

3 The Monte Carlo referenced above represent the likelihood of various random outcomes which are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. There can be no assurance that the projected or simulated results will be achieved or sustained. The numbers referenced only present a range of possible outcomes. Actual results will vary, and such results may be better or worse than the simulated scenarios. Clients should be aware that the potential for loss (or gain) may be greater than demonstrated in the simulations. Please note that the analysis does not take into consideration all asset classes, and other asset classes not considered may have characteristics similar or superior to those being analyzed.

This material is not intended to present an opinion on legal or tax matters. Please consult with your attorney or tax advisor.

Life Settlements and Fiduciary Duty

Dr. Andrea Brockman and Dr. Vincent DiLorenzo

The History of Life Settlements

In 1911, Dr. A. H. Grigsby, a physician, treated a patient by the name of John C. Burchard. Mr. Burchard needed medical attention but could not afford the doctor's services. The patient offered to sell his life insurance policy to Dr. Grigsby for $100.00 in exchange for those needed medical services. As long as Dr. Grigsby agreed to also pay the remaining premiums, the doctor would receive the death benefit proceeds as payment in full upon Mr. Burchard's passing.

Years later when Mr. Burchard died, Dr. Grigsby went to collect from the estate only to be denied his due by R.L. Russell, the executor of Mr. Burchard's estate who claimed that the doctor had no insurable interest. The lower courts agreed and the decision to not pay the doctor the death benefit was upheld when challenged in Appeals Court.

But that was not the end of it. The case was taken to the U.S. Supreme Court: GRIGSBY vs. RUSSELL, 222 U.S. 149 (1911). Justice Oliver Wendell Holmes delivered the opinion of the court that life insurance is to be considered personal property which can be assigned at the will of the owner. It was this historic decision that gave birth to what we now know as Life Settlements.

A Life Settlement is defined as the sale of an in-force life insurance policy to third party investors (institutional investors such as banks, hedge funds, pension plans, foreign investors…) for more than the cash surrender value (on average, 3-5 times) but less than the death benefit.

The Evolution of Life Settlements

There are two main events or eras associated with life settlements. The first was the AIDs epidemic in the 80's. When the cost of experimental treatment was out of reach for most and not covered by health insurance, many were able to sell their life insurance policies to individuals willing to pay a generous sum. These transactions known as Viaticals gave hope where there was none by providing the needed cash to afford the drugs and hospitalizations.

The second era occurred in the late 90's and early 2000's. Unprincipled individuals would purchase very large life insurance policies on total strangers, pay all the premiums for the next two years, and offer the insured sickly elderly person an attractive sum of money to do this transaction. If the person hadn't died during that time (whose named beneficiary would have been entitled to a death benefit) the policy owner could sell the policy after the two year "wet ink" period to investors for a huge sum. This was known as a STOLI (Stranger Originated Life Insurance).

STOLIs of course are not only unscrupulous, but also considered illegal. The bright light that came out of this "era" was the regulation of the life settlement industry. The Life Settlement Model Act, supported by both NCOIL (National Conference of Insurance Legislators) and NAIC (National Association of Insurance Commissioners) is the standard whereby life settlement transactions must comply in states who regulate Life Settlements.

But there is a huge lack of public awareness and understanding about life settlements. Oftentimes insurance agents and financial advisors may not be permitted to tell their clients about them or participate in the process.

There are resources available at the Life Insurance Settlement Association (www.lisa.org) so that you can learn more. In general, state departments of insurance are the regulatory authority over the secondary market for life insurance. They are in charge of licensing and enforcing the rules and regulations related to life settlement transactions.

Life insurance should be viewed as an investment that can be sold only if it's no longer the appropriate product

We would like to point out that in this paper, we are addressing only life insurance policies where there was an insurable interest at the inception of the policy. We are not encouraging life settlements for policyowners who wish to leave the entire death benefit to heirs. For the majority of policy owners, maintaining their current policy will continue to be the best course or they can take advantage of options offered by the carrier. But the mere presence of the secondary market gives them the means to evaluate what the policy is worth in empirical terms.

Clients over age 65 may have life insurance policies where premiums have become a burden or their life circumstances change and the policy may no longer be needed. Surrendering policies can result in significant losses for individuals who have been paying premiums on their policies for years. If they let the policy lapse or stop paying at the end of a term policy, they get nothing at all. Life insurance can be more than a tool for risk- management. It is also an asset with significant value that should be appraised and considered alongside one's real estate, businesses or equities.

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Life Settlements continued

Statistics

- $27 Trillion of In-Force Life Insurance (2009 Conning Research)
- $972 Billion of Life Insurance let go in 2010 (Bernstein Research 2010)
- $649 Billion lapsed or surrendered in 2012 ((American Council of Life Insurers 2013)
- $492 Billion of In-Force Life Insurance of those 65 years and older (Wall Street Journal)
- 88-90% of Term Life Insurance policies never pay out the death benefit (Conning Research)
- Only about 12% of U.S.-issued universal life insurance policies result in payment of a claim

So why would anyone want to sell their life insurance policy?

Many retirees need cash to finance large end-of-life health expenses, and life settlements allow seniors to turn existing life insurance policies into a kind of long-term care contract. The extra funds may make it less likely that an adult child will need to quit their job in order to assume the role of primary caregiver.

Clients may also need to dispose of their life insurance before qualifying for Medicaid. Rather than surrendering for cash value, the amount of funds from a life settlement could be as high as 60% of the face value. This would allow the patient to stay in assisted living, continue with home care, and not go into a Medicaid facility. The facilities and agencies get their full fee and the state saves money in deferred Medicaid payments. The proceeds used for lifecare are considered a qualified Medicaid Spend Down and not subject to the five year look-back.

Now, like every other asset, life insurance policies have a Market Value

Policyholders have the option of selling their unwanted or unneeded life insurance policies for immediate cash, generally 3-5 times what the insurance carrier offers for a cash surrender value. The life settlement option allows the seller of the policy to use the proceeds to help pay for long-term care needs, living expenses, new investments, paying off a mortgage, helping with school loans or anything else they desire.

Among the reasons for Life Settlements are:

- The insured's circumstances have changed and they no longer need the coverage
- Other assets are in place and beneficiaries are taken care of financially
- Premiums are excessive
- Estate tax laws have changed and policies for estate tax payments are no longer needed
- Perhaps the insured outlived the beneficiary
- UL policies promising 8-12% ROI now eat into cash value or have premiums due
- Liquidity may be needed
- Debt reduction
- Multiple policies in place
- Term policies mature
- Better investment opportunities
- Health and Lifecare needs
- Retirement needs or desires
- Business owned insurance proceeds needed for buyouts
- Funding or dismantling a Trust
- Charitable Giving

Philanthropy… where A Life Settlement helps individuals repurpose their life insurance assets for their highest and best use

Larry Raff from the Principal of Copley Raff, Inc., a Boston based philanthropy consulting firm points out that since more wealth is in the hands of a smaller and smaller percentage of the population, overall giving is coming from fewer and fewer people. And because the real earning power for the middle class has weakened over the past 20 years, the contributions have not only been steadily shrinking, but there is a decline in donor retention and new donor acquisition.

Philanthropic institutions are sitting on a gold mine

Consider another possibility of assets available for donation that would increase the dollar amount from the wealthier segment as well as open up the market to the middle class senior population. There are currently forty million+ people over age 65 who have life insurance with an approximate face value of $750 billion+. ICR Custom Market Research surveyed seniors and found that 55 percent of the respondents allowed their life insurance policies to lapse and 82 percent of respondents were not aware that alternatives like a life settlement existed.

A separate study conducted by the Insurance Studies Institute (ISI) found that 90 percent of seniors who lapsed a life insurance policy would have considered a life settlement had they been aware of the possibility. Also in this study, ISI found that 49 percent of financial advisors lack knowledge about life settlements and therefore do not recommend to their clients the possibility of selling their life insurance policy.

Life Settlements can be a tax-favored source for philanthropic

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Life Settlements continued

giving without taking a penny out one's pocketbook. Here, there are two distinct ways that policyowners can make a major gift donation.

1. The donor may contribute proceeds from a life settlement. or
2. Have the policy first appraised for its fair market value and then donate the policy to the charity who becomes the new owner and beneficiary. The charity does the life settlement with permission of the insured.

The more development officers know about the option of life settlements, the better they can fulfill the mission of the organization and advance their future.

Of course, legal and tax advice is recommended in all scenarios.

Estate Plans

Estate needs have likely changed. Certainly the estate tax laws have. The estate may have diminished in value through gifting or other reasons. A life insurance policy formerly taken out to pay estate taxes may no longer be necessary. Insurance may no longer be needed for liquidity.

Any amount greater than the cash surrender value is additional money in your client's pocket.

The London Business School research submits that seniors receive four times more by selling to an investor (either directly or through a broker) than they do from selling their policies back to insurance companies. A potential seller can assure getting the highest bid for a life settlement by working through a broker who shops and negotiates the most valuable contract among the various providers available.

Wealth Management

Financial advisors have the opportunity, if not the fiduciary duty, to help their clients discover hidden value in life insurance policies. An otherwise dormant asset, the life insurance policy, can be liquefied and the funds can supplement income or be used for other investments to meet current planning needs. Proceeds can fund an outright charitable gift or charitable trust. Funds allow making cash gifts to other family members.

Businesses may also benefit from selling a policy in the secondary market

There are instances where corporations have taken out policies on employees where it no longer makes sense to hold on to them.

- A buy/sell agreement on one partner's death - the company has been sold to a third party and the policies' original purpose is no longer a concern.
- The insured key person retires or is no longer involved in the business.
- The policy is part of litigation among partners.
- The policy was purchased to fund deferred compensation or other benefit programs that have now changed.
- The company must sell assets to raise cash. Common reasons may include:
  - Purchasing an interest in another enterprise
  - Facilitating the transfer of a business to the next generation
  - Repaying debt
  - Buying back stock from a partner or shareholder
  - Charitable donations

Types of Policies the Qualify for Life Settlements

Any type of life insurance can be considered for a life settlement. The best examples are Universal Life (UL), Term Convertible to Universal Life, and Joint Survivorship Universal Life (SUL). Term policies can often be converted into UL without any additional underwriting requirements by the life insurance carriers. Variable Universal Life (VUL) may be considered as well. Whole life insurance policies typically have a large amount of cash value built up within the policies, and require high premiums, sometimes making these policies ineligible for a life settlement.

It is generally known that term policies do not accrue any cash value. When the term ends or the policyowner allows the policy to lapse, no money is due back for premiums paid. However in certain instances where a conversion option exists, the policy could have a great deal of value to an investor. This is found money for the policyowner.

A Term policy, if used specifically to fund immediate long term care needs, does not require a conversion option.

The factors for eligibility of a policy for a life settlement:

- Face value is between $50,000 and $15,000,000 (There are more buyers in the market when the face value exceeds $250,000)
- The policy is beyond the two year contestability period
- The policy is in good standing with the insurance carrier
- The policy owner had an insurable interest at the time of policy issuance

The value of a policy will depend on many factors. Since this is an investment for the buyer, it stands to reason that the lower the cost to carry the policy and the faster the expected

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Life Settlements continued

payment upon death of the insured, the more attractive an offer a policy is likely to attract. However, the key factors are:

- Insured's age (the older the insured, the higher the likely offer)
- Medical history and estimated life expectancy (the more severe the health impairments, the higher the likely offer)
- Policy face amount and premium obligations (the lower the premium costs, the higher the likely offer)
- Existing Policy structure – there are many variations ranging from term policies with conversion option, to universal life policies, whole life, variable life, etc. Differences in policy guarantees, etc. will impact the price offered.
- Policy current cash value and prevailing interest rates

The information above, along with a policy illustration provided by the insurance company is used to calculate a policy value.

Keep a Portion of the Death Benefit

If your client's current policy is too expensive, but they still need some protection, it may be possible to cash out just part of the policy and retain some of the life insurance benefits. By selling a portion of the policy in the secondary market, the insured would no longer have to make premium payments, could collect a cash settlement for current expenses, and still retain a portion of the death benefit. The new policy owner will then pay the premiums on the entire policy up and until the death benefit is realized. At that time, the retained portion is paid to the seller (or its designated beneficiary). Also, some life insurance companies allow a policy to be split into two policies, which would allow the policyowner to sell one of the policies in the secondary market. The sale of a life insurance policy may be a taxable event.

Competent tax advice should be sought in all life settlement transactions

While tax experts have differing opinions on the details of taxation, there is a general consensus that if the cash surrender value of the policy exceeds the premiums paid on it, the life settlement will be taxed as follows:

- The portion of the payment up to the policy owner's investment in the contract will be received tax free.
- The portion exceeding the investment in the contract, but not exceeding the cash surrender value, will be taxed as ordinary income.
- The portion exceeding the cash surrender value will be a gain which, in some circumstances, may be a capital gain.

Payment structures are generally flexible to meet the seller's needs. The most common payment methods include lump sum, installments (to defer taxes) and annuities.

Your Knowledge brings Rewards

While Life Settlements are not for everyone, nor would every policy qualify, the client should be given the option where it is fully explained and the suitability is evaluated. From the financial end, there is no outlay of fees to enter into a life settlement. Medical exams of the insured are not required.

A life insurance policy can be a powerful wealth management, financial planning, and philanthropic tool. Seniors' Advisors, including Geriatric Care Managers, Life Insurance Agents, Financial Planners, Eldercare and Estate attorneys, CPAs, Trust Officers, Fundraisers, and Industry Organizations can all play an important role in awareness of repurposing life insurance. By educating seniors and their families, senior services industries, philanthropy consultants, and business benefits departments of the life settlement option, opportunities open for investment, business cash flow, debt reduction, retirement living, and health expenditures.

__Lifetime Horizons, LLC__ is a licensed brokerage company devoted to facilitating the process of Life Settlement transactions. Dr. Vincent DiLorenzo and Dr. Andrea Brockman act as liaisons between all involved parties providing education, insight, and confidentiality. Their objectives are threefold: 1) to establish suitability, 2) to expediently assist the insured and their advisors in managing communications and official procedures in the Life Settlement process, and 3) to obtain the highest value from reputable and well financed third party institutional investors.

Dr. Vincent DiLorenzo and Dr. Andrea Brockman are President and CEO, respectively, of __Lifetime Horizons, LLC__. , brokerage services for Life Settlement transactions.

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ANNUAL MEETING, SEMINAR & RECEPTION

"Estate Planning for Business Owners –
Maximizing the Value of the Business to Benefit Both Family and Charity"

Presented by:

Michael V. Bourland	**Christopher R. Hoyt**
Founding Shareholder	**University of Missouri -**
Bourland, Wall & Wenzel, P.C.	**Kansas City School of Law**

DATE:	**Thursday, May 7, 2015**
TIME:	**3:00 – 3:30 p.m. – Registration**
	3:30 – 6:00 p.m. – Council Remarks & Program
	6:00 – 8:00 p.m. – Reception & Gallery Access
LOCATION:	**Philadelphia Museum of Art** **Program in Van Pelt Auditorium/Reception in Great Stair Hall** **2600 Benjamin Franklin Parkway, Philadelphia, PA 19130**

REGISTER at www.philaepc.org

PEPC Outreach Committee

Volunteers from the PEPC Outreach Committee participated in the annual Philly Spring Cleanup event on Saturday, April 11th. PEPC members and their families helped clean up the Schuylkill Banks with trash pickup, graffiti removal, bagging leaves and rubble, prepping planting beds for spring, and filling in dirt trenches along the trail.

NAEPC® Notes

M. Eileen Dougherty, CTFA, CFP®, AEP®, ChFC®

It's Save the Date time again, and the 52nd Annual NAEPC Conference is right around the corner. This year the conference will be held at the recently re-imagined Omni Amelia Island Plantation Resort in Amelia Island Florida on November 19th and November 20th. There will be two full days of multi-disciplinary technical education with approximately 15 hours of credits available. Our schedule so far, looks like this;

Steve R. Akers, JD, AEP® (Distinguished): "Annual Update" & "Exclusive AEP® Session: A Dialogue with Steve Akers"

Janelle Benefield: "Financial Reform & Its Impact on Your Merchant Account"

Tom Breedlove: "The Case(s) for Household Employment Compliance: Case Studies Illustrating How to Mitigate Tax & Legal Risk"

Mickey R. Davis, JD: "All About that Basis: Creative Ways to Obtain Basis at Death"

Samuel A. Donaldson, JD, LL.M., AEP® (Distinguished): "Dealing with Uncle Sam, Everyone's Least Favorite Relative in the Family Business (Income Tax Planning for Closely-held Businesses)"

Michael W. Halloran, CFP®, CLU®, ChFC®, AEP® (Distinguished) Nominee: "Due Diligence in Selecting and Understanding Life Insurance Policies"

Stephan R. Leimberg, JD, AEP® (Distinguished): "Life Insurance - Key Cases and Rulings of 2014-15"

Richard A. Oshins, JD, LL.M., MBA, AEP® (Distinguished): "Improving (and/or Revisiting) Popular Estate Planning Strategies"

Jeffrey N. Pennell, JD: Third Party Trusts in Divorce - Is a Beneficiary's Interest Marital Property?"

John W. Porter, B.B.A., JD, AEP® (Distinguished): "The 30,000 Foot View from the Trenches: A Potpourri of Transfer Tax Issues on the IRS's Radar Screen"

Nancy B. Rapoport, JD: "Nudging More Ethical Behavior through Incentives and Checklists"

Martin M. Shenkman, CPA, PFS, MBA, JD, AEP® (Distinguished): "Planning Potpourri"

Diana S.C. Zeydel, JD, LL.M.: "Portability or No: Death of the Credit Shelter Trust"

If you would like more information about the conference, just go to www.naepc.org/conference. I hope to see you there!

At the NAEPC website you can also read the latest issue of the NAEPC Journal of Estate & Tax Planning. In addition to the regular columns and reports for the first quarter you will also find Marty Shenkman's Heckerling 2015 Nuggets, Gerry Beyer's article entitled "Web Meets the Will: Estate Planning for Digital Assets" and Steve Aker's article "Planning for Estates Under the $10 Million Exemption" and many more items of interest.

And finally, watch the website for updates on the latest offerings in The Robert G, Alexander Webinar Series. We have been delighted to have gifted presenters in the past such as Bernie Krooks speaking about "Special Needs Trusts, What Every Estate Planner Needs to Know" and our own Al Gibbons, who spoke on "How Collaborative Teams Work and Why They Are Essential For High Net Worth Clients". As a member of PEPC you are entitled to a discounted registration fee, and to past presentations. From time to time, free webinars are added to the calendar and one is coming up on 5/13/15 entitled "Case Studies on In-Home Care: Important Information for Your Clients".

As always, please call me if you need more information about your membership in NAEPC.

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P: 215.585.1988 • F: 215.585.5488

March Luncheon Program

PEPC President Rebecca Rosenberger Smolen, Speaker Amy E. Heller and Meeting Sponsor Peter Klenk

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Mark Your Calendar

2015-2016 Luncheon Programs – 11:45 – 1:45 p.m.
All luncheon programs are held at The Union League,
140 South Broad Street, Philadelphia.
Register at www.philaepc.org

Wednesday, September 16, 2015
Topic: Law and Economics of Fiduciary Investment
Speaker: Robert H. Sitkoff
Harvard Law School
Cambridge, MA

Tuesday, October 20, 2015
Topic: Planning for Non-Conventional Families
Speaker: Lauren J. Wolven
Levenfeld Pearlstein
Chicago, IL

Tuesday, November 17, 2015
Topic: TBD
Speaker: Steve R. Akers
Bessemer Trust
Dallas, TX

Tuesday, January 19, 2016
Topic: Leaders Metrics Ethos
Speaker: Don Trone
3Ethos
Mystic, CT

Tuesday, February 16, 2016
Topic: Annuities & Insurance
Speaker: Michael Amoia, JD, LLM (Tax), CFP, CLU, ChFC
Crump Life Insurance Services
Bethesda, MD

Tuesday, March 15, 2016
Topic: Elder Law
Speaker: Bernard A. Krooks
Littman Krooks LLP
New York, NY

Sign Up for a PEPC Committee

The Philadelphia Estate Planning Council offers many opportunities for member involvement. One of the most rewarding ways to get involved is through our many committees. The committees encompass all activities of the council including planning our social events, publishing our highly informative newsletter, enhancing our website and developing our education programs. All members are encouraged to actively participate on a committee. Committee participation provides the opportunity to expand your professional relationships and increase your leadership skills. To sign up, please contact the PEPC Office at staff@ philaepc.org.

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