

Tulsa Estate Planning Forum  
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**THAT LIFE INSURANCE POLICY MAY BE  
WORTH MORE THAN YOU THINK!**

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# GENERAL TYPES OF LIFE INSURANCE POLICIES

- Term Insurance – Pure Death Benefit
- Permanent Insurance – Death Benefit Plus Cash Value

# TERM INSURANCE

- Annual Renewable Term
  - No Cash Value, Convertible, Premium Increases Annually
- Level Term
  - No Cash Value, Convertible, Level Premium, Perhaps Renewable
- Group Term
  - No Cash Value, Convertible, Tax Advantage

# PERMANENT INSURANCE

- Whole Life
  - Fixed Premium; Death Benefit and Minimum Cash Value Guaranteed
  - Dividends; Loans
- Single Premium/Limited Pay
  - Single Premium – Whole Life Paid Up with One Premium
  - Limited Pay – Whole Life Paid Up With More Than One Premium

# PERMANENT INSURANCE (Cont.)

- Traditional Universal Life
  - Flexible Premiums
  - Adjustable Death Benefit
  - Few Guarantees
    - Death Benefit as Long as Cash Value Able to Pay Charges & Expenses
    - Minimum Interest Credit to Cash Value
  - Death Benefit Options – A, B and C

# PERMANENT INSURANCE (Cont.)

- Traditional Universal Life (Cont.)
  - Cash Value Bucket – Premiums Plus Interest Less Mortality Charge Less Expenses
  - Withdrawals, Loans; Surrender Charges
- Indexed Universal Life
  - Part of Cash Value mimics investing in Equity Index Funds
  - Subject to Floor, Ceiling, Participation Rate

# PERMANENT INSURANCE (Cont.)

- Variable Universal Life
  - Cash Value Invested in Carrier Mutual Funds
  - Subject to SEC
  - Protected from Carrier Creditors
  - No Minimum Guaranteed interest
- No Lapse Guarantee Universal Life
  - Death Benefit Guaranteed If Premium Paid
  - Fixed Premium; Little or No Cash Value

# INCOME TAX VALUE OF POLICY

- Charitable Income Tax Deduction
  - Lesser of Fair Market Value (FMV) and Basis
  - Basis of Insurance Policy
    - Premium Paid
    - Plus Other Considerations
    - Less Dividends and Withdrawals
  - FMV – Use Gift Tax Rules
  - If FMV over \$5,000, Must Appraise Policy
  - Basis of Life Settlement Policy?

# INCOME TAX VALUE OF POLICY (Cont.)

- Income From Policy Transfers – FMV
  - Sec. 402(a) – Qualified Plan Distribution or Sale
  - Sec. 79 – Group Insurance with Permanent Benefits
  - Sec. 83 and Sec. 402(b) Trust – Transfer in Connection with Services

# INCOME TAX VALUE OF POLICY (Cont.)

- What is Income Tax FMV?
  - Rev. Proc. 2005-25 – Cash Value and All Other Policy Rights
  - Safe harbors for Variable and Non-variable policies
    - Greater of Interpolated Terminal Reserve Plus Unused Premiums OR
    - PERC (premiums+ Earnings Less Reasonable Charges)
    - No Surrender Charge Reduction for Sec. 79, 83 and 402(b) but Partial for Sec. 402(a)
  - Appraisal to Overcome High PERC Safe Harbor

# INCOME TAX VALUE OF POLICY (Cont.)

- Sec. 402(b) nonqualified Trust Vesting or Distribution
- IRS Position – FMV not reduced by Surrender Charges
- Schwab Case – Surrender Charge Reduction Not Automatic for Taxable Distribution
- Cadwell Case – Surrender Charge Reduction for Taxable Vesting (Maybe)

## Conclusion:

- No Surrender Charge Reduction Unless Taxpayer Shows Reasonable Alternative (Appraisal)?

# GIFT TAX VALUE OF POLICY

- Replacement Value
- Rules of Thumb
  - New Policy – Initial Annual Premium
  - Single Premium/Paid Up – Premium for New Policy at Insured's Age at Gift
  - Existing Permanent Policy – Interpolated Terminal Reserve Plus Unused Premium

# GIFT TAX VALUE OF POLICY (Cont.)

- Interpolated Terminal Reserve (Cont.)
  - Doesn't Fit Well for Universal and Variable Life
  - What Reserve? No Guidance
    - Tax Reserve or Statutory Reserve
    - No Lapse Guarantee – AG 38 and Deficiency Reserves
- Some Carriers List Several Reserves on Form 712
  - Avoid Surprise; May Need Appraisal

# GIFT TAX VALUE OF POLICY (Cont.)

- Rules of Thumb (Cont.)
  - Term Policy
    - Unused Premium
    - Level Term Has Reserves
  - Group Term – Unused Table I Premium (Usually)
  - Split Dollar – Interpolated Terminal Reserve plus Unused Premium Less Employer's Interest

# GIFT TAX VALUE OF POLICY (Cont.)

- Unusual Nature of Policy Exception To Rules of Thumb – Poor Health Increases Value
- Life Settlement Market – IRS Has Not Yet Adopted Potential Purchase Price
- Rev. Proc. 2005-25 Income Value PERC – Apply to gift?

# ESTATE TAX VALUE OF POLICY

- Occurs When Non-Insured Owner Dies
- Occurs When First To Die under Second To Die Policy
- Replacement Value
- Gift Tax Rules of Thumb Apply
- Adequate and Full Consideration Sale to Avoid Section 2035
  - Rule of Thumb OR Policy Face Value?

# GST TAX VALUE OF POLICY

- Value for GST Exemption Allocation – Use Estate or Gift Tax Value Rules
- Timing of GST Allocation to Life Time Transfers
  - Automatic or Timely Filed – Date of Transfer
  - Untimely Filed – Date of Filing Form 709
  - ETIP Delays Allocation
- Taxable GST Transfers if No GST Exemption
  - Taxable Termination or Taxable Distribution
  - Direct Skip