WINGED KEEL GROUP®

Winged Keel Group Insights

Life Insurance Financing: Economic Benefit Split Dollar

Winged Keel Group Insights is a publication designed to create education and awareness around life insurance topics and solutions that may address certain needs of your clients and their multidisciplinary goals.

How Economic Benefit Split Dollar Provides a Life Insurance Financing Solution in a Rising Interest Rate Environment

With the passage of the Tax Cuts and Jobs Act (TCJA), the unified credit amount effectively doubled beginning in 2018, and has continued increasing as it is indexed for inflation based on the consumer price index. The unified credit amount will be increasing by 5.3% in 2024 to $13,610,000 per person from the 2023 amount of $12,920,000. However, absent any Congressional action, the unified credit amount is scheduled to revert in 2026 to a $5,000,000 base amount per person, adjusted for inflation. This puts clients squarely in a "use it or lose it" situation.

Life insurance can be an effective tool to leverage a client's increased inflation-adjusted exemption amount for the following reasons:

- Produces income tax-free returns that are not correlated with any other asset class, thereby providing diversification and stability to the family's intergenerational wealth
- Provides attractive returns (IRRs) at life expectancy
- Provides attractive multiples on premium deposits
- The premium schedule and insurance benefit are fully guaranteed for applicable guaranteed life insurance products

However, for those clients who prefer to use their increased unified credit amounts for other wealth transfer planning strategies, split dollar can be a very valuable tool to efficiently fund trust-owned life insurance while minimizing any potential gift and GST tax considerations.

Loan regime split dollar provided attractive economics under the low interest rates over the past several years. But after a historically low interest rate environment, AFR rates have now increased to levels not seen in almost 15 years with the current December 2023 long-term AFR rate at 5.03%.

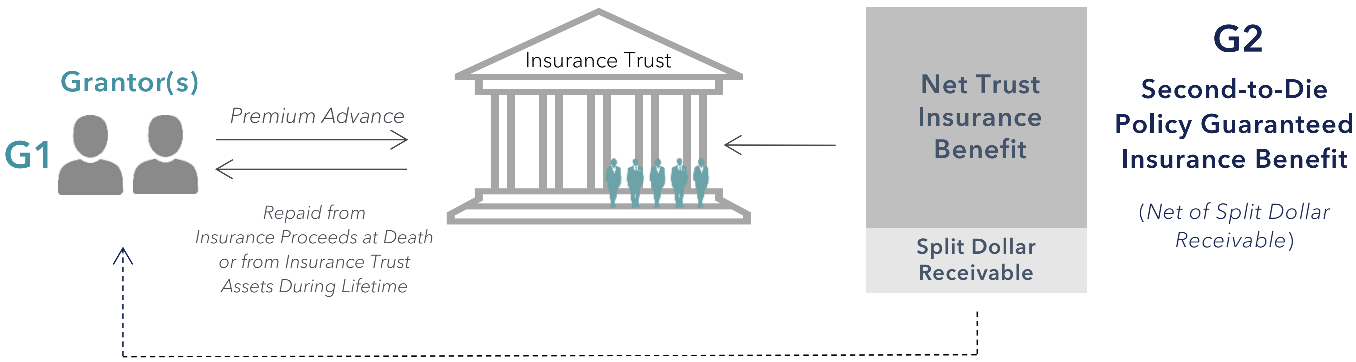
As we look ahead to the sunsetting of the provisions within the TCJA and rising AFR rates, economic benefit regime split dollar is a powerful wealth transfer planning tool to be reconsidered.

Why Economic Benefit Regime Split Dollar:

- For clients who want to take advantage of the higher unified credit amounts for non-life insurance wealth transfer planning
- For clients who have taken advantage of the higher unified credit amounts and have limited to no exemption remaining
- For clients who want to hedge against the sunsetting of the TCJA provisions
- For successful non-GST exempt trusts to shift assets to GST exempt trusts

Basics of Economic Benefit Regime Split Dollar:

Private economic benefit regime split dollar allows clients to fund significant amounts of insurance while minimizing and deferring transfer tax costs. A Grantor advances premiums for an Irrevocable Life Insurance Trust's (ILIT) acquisition of an individual or second-to-die life insurance policy. The Grantor retains an interest in the policy equal to the greater of the cumulative premium advances or the policy account value.



Under the economic benefit regime, the value of the Grantor's annual gift is based on the ages of the two insureds and is initially very low. In essence, the IRS rules enable clients to lend funds on a long-term basis at interest rates vastly below market rates. This frees up the client to use annual exclusion gifts and unified credit amounts for other wealth transfer strategies.

The economic benefit value while both insureds are alive is minimal, but a contingency plan is recommended for the increase in economic benefit value that occurs after the first death.

Even for clients who may have made gifts back in 2018, the impact of the inflation adjustments provides an additional capacity to gift $2.43M per person in 2024.

For these clients, private split dollar provides a gift tax efficient structure to fund large life insurance premiums and can provide time while gifted assets either have value realization events (VREs), appreciate in value over time, or other planning strategies are completed. These assets can then potentially be available in the future as a contingency plan to exit the split dollar arrangement.

		Five Annual Premiums Guaranteed Second-to-Die Policy			Impact to Clients				Impact to Heirs	
Year	Ages	Guaranteed Annual Premium	Guaranteed Insurance Benefit	IRR	Annual Premium Advance	Insurance Benefit (Included in Estate)	Reportable Economic Benefit Per IRS	Economic Benefit Equivalent Interest Rate	Trust Insurance Benefit	Total Value to Heirs
1	44 / 44	3,170,663	100,000,000	3053.91%	3,170,663	3,170,663	194	0.01%	96,829,337	98,731,735
2	45 / 45	3,170,663	100,000,000	413.82%	3,170,663	6,341,326	187	0.00%	93,658,674	97,463,470
3	46 / 46	3,170,663	100,000,000	176.47%	3,170,663	9,511,989	271	0.00%	90,488,011	96,195,204
4	47 / 47	3,170,663	100,000,000	103.08%	3,170,663	12,682,652	262	0.00%	87,317,348	94,926,939
5	48 / 48	3,170,663	100,000,000	69.30%	3,170,663	15,853,315	337	0.00%	84,146,685	93,658,674
10	53 / 53	0	100,000,000	25.11%	0	15,853,315	841	0.01%	84,146,685	93,658,674
20	63 / 63	0	100,000,000	10.71%	0	15,853,315	7,152	0.05%	84,146,685	93,658,674
25	68 / 68	0	100,000,000	8.31%	0	15,853,315	24,655	0.16%	84,146,685	93,658,674
30	73 / 73	0	100,000,000	6.78%	0	15,853,315	65,550	0.41%	84,146,685	93,658,674
35	78 / 78	0	100,000,000	5.73%	0	15,853,315	169,471	1.07%	84,146,685	93,658,674
40	83 / 83	0	100,000,000	4.96%	0	15,853,315	460,535	2.90%	84,146,685	93,658,674

Results Based on $100M Policy Insuring 44-Year-Old Couple *

For clients who want to take advantage of the higher unified credit amounts for non-life insurance wealth transfer planning:

The current environment provides an unprecedented opportunity for clients to gift assets to estate exempt trusts without incurring gift or GST tax. Clients may prefer to use the higher unified credit amounts to gift (or sell) discounted assets or hard-to-value assets to trust instead of using the higher amount for life insurance premiums.

For clients who have taken advantage of the higher unified credit amounts and have limited to no exemption remaining:

Similar to the above, many clients have already taken advantage of the higher unified credit amounts and simply do not have any meaningful exemption remaining to fund large life insurance acquisitions. Annual exclusions gifts ($18,000 in 2024 per person per beneficiary) have inherent limitations and for most clients may already be consumed by the beneficiaries.

Private split dollar provides a means to minimize and defer the transfer tax costs associated with funding a large trust-owned life insurance acquisition. To the extent that there is any remaining exemption or annual exclusion gifts, the annual economic benefit value can be gifted to the trust and used to reduce the amount of premium advanced by the Grantor (also known as contributory split dollar).

For clients who want to hedge against the sunsetting of the TCJA provisions:

In the absence of Congressional action, the unified credit amount is scheduled to sunset at the end of 2025. However, it is possible that Congress could act prior to December 31, 2025 to extend the provisions of the TCJA. For clients who may be unable or unwilling to make a sizeable gift or want to hedge the potential extension of the TCJA, private split dollar provides a low-cost mechanism to establish such a hedge as an alternative to or in addition to a SLAT.

A trust-owned life insurance portfolio can be acquired appropriately sized with a core estate planning insurance benefit amount and an ancillary policy equal to the amount of the sunsetting exemption amount. The premiums can be funded using private split dollar requiring a de minimis amount of exemption. Following 2025, the client can decide if they want to retain the policy and maintain the private split dollar arrangement.

For successful non-GST exempt trusts to shift assets to GST exempt trusts:

Successful prior wealth transfer planning may result in assets being overweighted in a non-GST exempt trust relative to the Grantor's current generational wealth transfer planning objectives. This is especially true of successful GRATs where GST exemption cannot be efficiently allocated. Under such a scenario, trust-to-trust split dollar provides the ability to effectively reallocate funds from the non-GST exempt trust to the GST exempt trust. Unlike a promissory note or sale to trust, split dollar allows for the arrangement to remain outstanding for the life of the insured at a rate below a corresponding AFR interest rate.

Please contact us if you would like to explore how economic benefit split dollar can be accretive to your clients' wealth transfer planning. For more information on Winged Keel Group, please visit our website: wingedkeel.com

DISCLOSURES

The tax and legal references attached herein are designed to provide accurate and authoritative information with regard to the subject matter covered and are provided with the understanding that Winged Keel Group, Inc. is not engaged in rendering tax, legal, or actuarial services. If tax, legal, or actuarial advice is required, you should consult your accountant, attorney, or actuary. Winged Keel Group, Inc. does not replace those advisors.

All guarantees and benefits of the insurance policy are subject to the claims-paying ability of the issuing insurance company. The financial illustrations and other statements within this report, as well as comments made by any individuals, are not guaranteed and do not constitute a contract. Any contract entered into is between the policyowner and the insurance company, through its insurance policy. You should read the policy thoroughly.

By accepting these materials, the recipient agrees to keep the materials and their content confidential and not to use the materials or the content for any purpose other than to evaluate a financial transaction with Winged Keel Group, Inc. of the type described in the materials, except that there is no limitation on disclosure of the tax treatment or tax structure of the products and/or transaction structures contained herein. W4786; 6134452.1