



WINGED KEEL GROUP®

## Winged Keel Group Insights

# Modernized Estate Planning with Private Placement Life Insurance

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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.

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By **Brady C. Knight and Chelsea Maeda**

As we spring forward into 2021, ascending from the darkness of COVID-19, traditional thinking has been challenged as we reflect the importance of life, health, family, and finances. Our shared pandemic experiences have provided us the opportunity to abandon antiquated beliefs and enter a fresh new era of thoughtful and modernized estate, business, and asset protection planning. Today, we educate, problem-solve, and delay no further as we enter the enhanced age of properly constructed Private Placement Life Insurance (“PPLI”) for ultra high net worth individuals and families.

In summary, PPLI provides the ability to allocate to alternative investments, traditional long-only managers, and low-cost beta strategies, in a tax-efficient manner while creating efficiencies not found in other traditional life insurance solutions.

At this moment, there is a powerful confluence of critical factors that make thoughtful estate planning and the use of PPLI particularly attractive and time-sensitive:

- Lifetime exemption levels at all-time highs (\$11.7M per individual / \$23.4M per couple)
- April 2021 Mid-Term Applicable Federal Rate (“AFR”) is 0.89%
- Top marginal federal estate tax rate is 40% with a potential proposed increase
- Top marginal federal income tax rate is 37% with a potential proposed increase

- The effective elimination of State and Local Tax (SALT) deductions for UHNW families
- 200+ alternative investment strategies available through PPLI

For comparison, in 1996, an individual’s lifetime exemption was \$600K and the January Mid-Term AFR rate was 5.73%. The top marginal federal estate tax rate was 55% and the top marginal federal income tax rate was 39.6%. Note: PPLI was in its infancy with limited Insurance Dedicated Funds (IDFs) available.

There is current speculation that the estate tax exemption will decrease and that estate and income tax rates will increase. With these potential changes in mind, and even if the current tax environment remains, understanding the benefits that PPLI can add to a family’s income and wealth transfer planning is important.

Properly constructed PPLI creates a compelling investment and legacy planning opportunity:

- Accumulated investment income earned under a life insurance contract is not subject to current period taxation. Policy account values may be transferred among investment strategies within the policy without triggering tax recognition. This is particularly attractive when allocating among tax-inefficient alternative investments with high turnover. *[IRC 7702 (g)(1)(A)]*

- Assuming the policy is structured as a Non-Modified Endowment Contract (non-MEC), supplemental income can be distributed from PPLI using First In First Out (FIFO) accounting whereby the distribution of basis is taken without recognition of income tax. Additionally, policy loans of up to approximately 85% of the PPLI cash value can be distributed at a minimal cost income tax-free. [IRC 72 (e)(5)]
- Insurance benefits received from a life insurance contract, including any accumulated investment income, are generally received income tax-free. [IRC 101 (a)(1)]
- If properly arranged, the proceeds of a life insurance policy paid to an irrevocable trust will be excluded from the taxable estate of the insured. With lifetime exemption levels at all-time highs and the Mid-Term AFR at sub 1%, now is the time to gift or loan money to an irrevocable trust.

Given the fact the Federal Reserve has been reducing interest rates since the early 2000's, traditional life insurance product lines (Whole Life, Universal Life, Indexed Universal Life) have been adversely affected and should be reviewed. All major life insurance companies have been affected by the Federal Reserve's interest rate reduction policy, resulting in suppressed life insurance policy dividend and / or interest crediting rates. The lower the crediting rate, the less cash value growth within the policy, which often leads to increased premium obligations. Many consumers of traditional life insurance products are not aware of the correlation between interest rates, policy charges, and long-term policy performance.

PPLI combines the protection and tax advantages of life insurance with a robust investment platform on which to allocate. Policy owners can allocate (and reallocate) to comingled or customized investment options made available by the insurance company. The array of available investment options has grown significantly in recent years. PPLI pricing is fully transparent with fees and charges that are lower than traditional products. PPLI policies are typically designed to minimize policy charges in order to maximize long-term account value and insurance benefit growth. The annualized "cost" of PPLI averages roughly 50-70 basis points over the lifetime of the insured and can prove quite compelling especially when entering an increasing tax-rate-environment. That said, PPLI should be viewed as a long-term investment that may not be suitable for all families.

As we recalibrate and contemplate planning opportunities in the current political environment, we think it is prudent to evaluate PPLI as a potential component of one's wealth transfer planning. Properly constructed and administered PPLI can be advantageous to ultra high net worth individuals and families, allowing for tax-efficient savings and wealth transfer opportunities for those willing to become educated on the subject and take action.

As we know, life is precious and full of unknowns, so challenge traditional thinking and procrastinate no longer.

"Someone's sitting in the shade today because someone planted a tree a long time ago."

– Warren Buffet

*Brady C. Knight and Chelsea Maeda are Principals at Winged Keel Group.*

## Disclosures

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