WHY YOUR AFFLUENT CLIENTS NEED

LIFE INSURANCE

NOW MORE THAN EVER

HIGH GROUND COMPANY

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INTRODUCTION

President Biden and the Democratic-led Congress may take action in 2021 to pass several tax increases targeting affluent individuals and businesses.

The expected new laws and policies would require these taxpayers to find additional sources of liquidity to meet rising transfer tax obligations at death and new wealth accumulation strategies to mitigate rising income tax obligations during life.

Life insurance can be a powerful solution to meet these needs and by starting the underwriting process today, a policyholder is able to preserve favorable policy pricing and performance features.

Why Your Affluent Clients May Need Life Insurance Now More Than Ever

TOPICS

TAX INCREASES THAT COULD BE AROUND THE CORNER

Recent tax increases proposed by Biden or other Democratic Party Representatives targeting high-income or high-net-worth individuals and business owners include:

- Reducing the combined federal exemption from $11,700,000 per person to as low as $3,500,000 with some proposals de-unifying the gift tax exemption to $1,000,000 per person.
- Increasing the top estate transfer tax rate to 55% or even 77% for the ultra-wealthy.
- Eliminating the step-up in basis of eligible property inherited at death and replacing it with a carry-over basis or Canadian-like recognition-at-death regime.
- Increasing the top ordinary income tax rate on income over $400,000 from 37% to 39.6% and adding a 12.4% Social Security payroll tax, split between the employee and employer, for wages over $400,000.
- Moving the long-term capital gains tax rate from 20% to 39.6% plus the 3.8% Net Investment Income Tax for taxpayers with more than $1,000,000 income.
- Limiting the tax benefit of deductions for retirement plan contributions to 28%.
- Boosting the corporate tax rate from 21% to 28% and limiting the Section 199A Qualified Business Income deduction for pass-through business owners earning more than $400,000.

These changes are in addition to those already enacted under the SECURE Act where Designated Beneficiaries (“DBs”, who are not Eligible DBs, of Individual Retirement Account (“IRA” or Defined Contribution Plan (“DCP” assets are now forced to liquidate such inherited accounts within 10 years of the account holder’s death for those dying after December 31, 2019. By combining this removal of the “stretch IRA” benefit with a proposed increase to the top marginal tax rate, IRA or DCP account holders previously planning on tax-efficiently passing on balances to their children and grandchildren now face the reality of a potentially significant loss in long-term family wealth due to this new postmortem acceleration of income taxation.

The Result—affluent individuals may keep less of what they earn, find their ability to accumulate wealth impaired and realize more of the wealth in their estate is lost to greater taxation at death.

A SOLUTION FOR HIGHER TRANSFER TAXES AND/OR POSTMORTEM INCOME TAXES

In planning for this policy shift and its impact, trusted advisors can turn to permanent life insurance and its preferential tax benefits as a recommend solution for their clients. Permanent life insurance has a competitive edge over other financial vehicles when it comes to providing future liquidity. The proceeds of the death benefit are payable in cash at the time the liquidity is needed and generally not included in the beneficiary’s gross income – essentially the only asset that can be eligible for a step-up in basis at death when owned outside the insured’s taxable estate where the proceeds can also avoid being subject to estate tax, if structured properly.

As part of a comprehensive estate plan, these characteristics can make trust-owned life insurance uniquely effective for replacing wealth lost to transfer taxes as well as providing liquidity to beneficiaries to offset future income taxes due to a carry-over basis or recognition-at-death for inherited appreciated property, the latter of which essentially is an additional transfer tax.

One gifting strategy for mitigating the costly effects of the new 10-year rule under the SECURE Act which has become increasingly popular is for the holder of an IRA or DCP to gift after-tax required minimum distributions ("RMBs" into a trust and outside of their estate. There, the amounts can be used to purchase the cash value life insurance needed to replace losses to the Designated Beneficiaries inflicted by losing the traditional "stretch IRA," proposed higher individual income tax rates as well as estate taxes, if applicable.

Establishing and paying for these policies is not limited to making use of the endangered federal estate and gift tax exclusions. A range of funding techniques provide increased flexibility for purchasing life insurance. Many of these techniques can be incorporated into an individual's overall estate plan using his or her irrevocable trust and include private split dollar arrangements, intra-family loans or installment sales and premium financing.

A SOLUTION FOR HIGHER INVESTMENT INCOME TAXES OR LESS VALUABLE RETIREMENT PLAN CONTRIBUTIONS

High-earning individuals facing increased taxation of investment income from the proposed tax policies can turn to cash value life insurance to provide tax-efficient wealth accumulation and supplemental income potential. The 28% tax benefit limit for contributing to a retirement plan and the increase in taxes paid on distributions could be a double-edged sword for saving. A wealth accumulation strategy incorporating cash value life insurance can provide for tax-deferred growth potential, income tax-free access to cash value via withdrawals up to cost basis and policy loans (assuming the policy does not lapse with an outstanding loan and never becomes a Modified Endowment Contract and whatever portion of the death benefit is left after any withdrawals or loans can be payable to the beneficiaries income tax free.

Techniques exist that can allow the policy to be trust owned, keeping the death benefit free of estate tax while preserving the ability for the grantor-insured to indirectly access the cash value. These techniques can include designating the insured's spouse as a trust beneficiary who can receive trust distributions (i.e., a Spousal Lifetime Access Trust, giving the grantor-insured the ability to borrow from the trust at arm's length, or funding the premiums through split dollar loans which can be repaid in the future plus interest, all of which the trustee can subsidize by borrowing from the cash value.

For nearly half of a century, cash value life insurance has been an efficient tool for businesses to informally fund executive benefits to their key employees. Similarly, business owners impacted by higher corporate taxes can make funding these benefits with taxable investments more costly, thus leading to challenges in recruiting, rewarding and retaining their most valuable employees. Life insurance not only can have a current positive impact on a corporate balance sheet via tax-deferred cash value growth and the ability to meet executive benefit liabilities through income tax-free withdrawals and policy loans but also to recover benefit plan costs from the death benefit which can also be received income tax free, if structured properly.

HOW TO ACT NOW WITH MINIMAL COST

Higher taxes may be coming soon and planning to deal with the impact, including obtaining life insurance, should start immediately. How much life insurance is needed will depend upon both the financial and estate planning conducted by an individual's trusted advisors and the contours of any final legislation.

These advisors can pinpoint the current liabilities to be addressed with life insurance, but what about gaps created by the proposed tax increases? Although the exact impact of any tax policies will not be known for months, there are 'wait-and-see' options with life insurance that are available now and can be considered.

One of the most valuable intangible assets a person has is their insurability. No one will be as young tomorrow as they are today nor generally as healthy. This means that life insurance will most likely never be as affordable as it is right now. When it comes to purchasing a new policy, gambling one's insurability on future legislative action by procrastinating can be a risky and costly bet.

Fortunately, policies obtained immediately can be adjusted to fit the outcome of the current tax proposals as well as any additional increases Congress may pass. In order to take advantage of their insurability and to get the process started, taxpayers targeted can consider buying a flexible premium, permanent policy with a sufficient amount of coverage to cover additional needs caused by possible tax increases and fund with a minimum amount of premium to keep the policy active for a short duration. Then, as any tax legislation is enacted and their new planning liabilities crystallize, the policyholder can increase the premiums accordingly, and/or reduce the face amount if necessary, to suit their needs.

Another 'wait-and-see' strategy allowing for the purchase of life insurance right away with flexibility for later is for the client to purchase a term life insurance policy which is convertible to a permanent, cash value policy. The policyholder could be assured of immediate coverage at a low cost and have the option of converting the term policy with no evidence of insurability in the future to meet their planning needs.

Advances in the underwriting process have led to less intrusive protocols for prospective insureds at most amounts of coverage sought. The ability to leverage 'big data', physician's statements and past experience allows life insurance companies to offer accelerated underwriting for clients seeking policies in upwards of $7.5 million. These accelerated programs may not require the insured take a medical exam and can issue a policy within days from the application. At higher amounts of coverage, the same underwriting advances can mean fewer tests, often triggered only by past medical history.

Call High Ground Company today to discuss the best planning options for you.

ABOUT HIGH GROUND COMPANY

Established in 2019, High Ground Company is rooted in experience, thought leadership, and tradition. With a combined 6 decades of experience, founders Hunter Ewing and Bo Wilkins are well-known in the insurance industry. Outstanding reputation and results mean that High Ground company is one of the best firms in the country to meet the needs of exceptional clients. High Ground Company leadership believes that the best process is a collaborative one that involves a client's entire team. Avoiding a silo approach allows for fluid planning and successful outcomes. Our firm is proud to work with some of the best Estate Planning Attorneys and CPAs in the Atlanta area and beyond. Our extensive network means we are fully prepared to work with business owners, affluent individuals, and their families while they navigate their insurance needs and options.

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