

# **Important Insurance Planning Opportunities After The American Taxpayer Relief Act of 2012**

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## BIOGRAPHY

**RICHARD M. MORGAN** is the founding partner of Morgan + DiSalvo, P.C. Mr. Morgan began his legal career in 1987 and started the firm in 1995. The firm is located in Alpharetta, Georgia, just east of GA 400 at the Haynes Bridge Road exit.

Morgan + DiSalvo is a boutique law firm which focuses on the areas of Estate Planning, Probate, Estate and Trust Administration, Charitable Giving and Charitable Organizations, Business Exit/Succession Planning, Business and Transactional Matters, Estate and Trust Dispute Resolution, Tax Planning, and Tax Controversies. Morgan + DiSalvo provides its clients with highly personalized service, technical sophistication, and extensive experience in its focus areas, helping clients design and implement plans and solutions which fit their needs and desires. Morgan + DiSalvo was recently chosen by U.S World & World Report as only one of 20 law firms to achieve Metro Tier 1 status in their listing of Best Law Firms in the area of Trusts & Estates in Georgia.

Mr. Morgan is a past President of the Estate Planning & Probate Section of the Atlanta Bar Association, the North Georgia Estate Planning Council, the Taxation Section of the Georgia Bar Association, the Taxation Section of the Atlanta Bar Association, and the Georgia Planned Giving Council. In addition to continuing membership in these and other professional organizations, Mr. Morgan is a member of the Partnership Sub-Committee of the Corporate Law Section and the Executive and Legislative Committees of the Fiduciary Law Section of the Georgia Bar Association. Mr. Morgan has also served on the professional advisory committees and in other leadership positions with several large, Atlanta, Georgia, based charitable organizations. He has earned the highest possible ratings from two of the most respected attorney rating services, including Martindale Hubbell / Lawyer.com (5.0 out of 5.0) and AVVO.com (10.0 out of 10.0). He was also selected for inclusion in Super Lawyers in Georgia in 2013, selected for inclusion in Best Lawyers in America in the practice area of Trusts & Estate for 2013, and was selected as a Five Star Wealth Manager every year since 2009.

Mr. Morgan received his B.B.A. in Accounting degree, *cum laude* (1984), and his law (J.D.) degree, *cum laude* (1987), from the University of Georgia, and he received his Master of Laws (LL.M.) in Taxation degree from Emory University (1992).

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# Important Insurance Planning Opportunities After The American Taxpayer Relief Act of 2012

*by Richard M. Morgan, JD, LLM*

I. **Introduction.** This paper supplements our materials entitled, “The American Taxpayer Relief Act of 2012: What do we do now?” The purpose of this supplement is to point out some of the important insurance planning opportunities under The American Taxpayer Relief Act of 2012 (“2012 Tax Act”). While the changes just now becoming effective in 2013 will have wide ranging and significant impact, we are still at the beginning stages of fully realizing the full effect of these changes on how our clients will plan their affairs.

## II. **Life Insurance Planning Opportunities.**

A. **The Normal, But Still Very Important, List.** Life Insurance (“LI”) can be a cost effective and efficient way to provide additional liquid funds when needed:

1. Pay for future possible taxes and debts.
2. Prevent forced sale because of illiquidity issues.
3. Create funds where do not otherwise have enough to care for family as desired, including where have special needs beneficiaries.
4. Help client make real impact through a large charitable contribution.
5. Create funds for possible exit strategies to enable unwinding other planning strategies.
6. Enable a spouse or child(ren) (from prior marriage or otherwise) to be “taken off the table” at the first spouse’s death in a blended family or other situation with significant risk of family dis-function.
7. For family business owners:
  - a. Buy-sell agreement funding.
  - b. Key man funding.
  - c. Enable evening up the estate among family where one or more will receive and/or work in the business and one or more will not.

### B. **Charitable Giving.**

1. Charitable Remainder Trusts (“CRTs”) with “wealth replacement” LI in Irrevocable LI trust (“ILIT”). Yes, these days may be coming back. Income tax planning for higher income taxpayers will push some to fund CRTs and LI (normally, but not always) purchased in an ILIT serves to replace the wealth for the family that will eventually be passing to the charity under the terms of the CRT. This strategy can create a very beneficial win-win-win for client, client’s family and charity.
2. Pass IRA and / or qualified plan (“QP”) assets to charity at owner’s death as a tax effective manner of benefitting charity and replace this wealth for the family with LI (normally, but not always) in an ILIT. This is a win-win since the charity will not pay income tax on this otherwise high taxed asset



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and the family receives the “replacement” LI proceeds on a tax-free basis. It should also be noted that the IRA or QP funds can pass directly to charity or to a charitable family foundation (including a donor advised fund, supporting organization or private foundation) to be effectively controlled for charitable purposes by the family, including the ability to receive reasonable compensation where a private foundation is utilized.

- C. **Leveraging the Gift, Estate & GST Tax Exclusions, with the possible ultimate leverage with LI owned in a Dynasty Trust.** LI can be used to leverage the benefits of transfers made to trusts to utilize the gift tax annual exclusions, the gift and estate tax exclusions (the “Basic exclusion amount” or “BEA”) and the GST tax exemption amount. Dynasty trusts are those that are intended to continue on for the family’s benefit for hundreds of years or longer, so utilizing the leverage of LI with a Dynasty Trust allows the leverage to have benefits lasting for potentially many generations.
- D. **Asset Protection Benefits.** LI and annuities are often given special protection from the claims of creditors, with the existence and level of such protection being determined by the applicable state’s laws. Under Georgia law, LI and annuities are given special protection from the claims of creditors outside of a bankruptcy. However, a bankruptcy court is not subject to such protections. Under Florida law, special protections from the claims of creditors exists both inside and outside of bankruptcy. In order to enhance this protection, the LI can utilize the asset protection benefits of trusts. Of course, with all asset protection planning, transfers made with the intent to avoid or delay a creditor claim is subject to being voided or worse under the applicable state law rules on fraudulent transfers.
- E. **Qualified Plans.** LI in limited amounts can be used to leverage the benefits of Defined Benefit (“DB”) plans. DB plans were off the radar of most professionals based on benefit limiting changes in the rules governing these plans over the years and the changing landscape of how long employees worked at a particular company. DB plans are about to hit their stride again because of the relaxing of the QP rules under the Pension Protection Act of 2006 along with the significant increase in income tax rate and the new 3.8% Medicare tax on higher income earners. In particular, in addition to providing the employer with more flexibility in the amount to be contributed from year to year, DB plans can now be cross-tested. Cross-testing plans seems like no big deal until an actuary explains what



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this means in practical terms. Basically, the contributions being made to a company's 401(k) or other defined contribution plan(s) can be used to support potentially much greater contributions for the owner or other higher paid employees in the DB plan. Actuaries also tell us that adding a limited amount of LI to these DB plans can significantly improve their performance as well. Utilizing a cross tested DB plan could have the effect of being a very big deal in practical effect, depending on the facts.

- F. **LI as Income Tax Planing Tool for Long-Term Investment Savings.** For those willing to commit savings for over 10 years (preferably 15 - 20 years), the use of specially designed LI policies could prove to be very beneficial. The desired LI policy structure will have will have the following attributes: (i) high relative cash value, (ii) minimum death benefit while maintaining status as LI, (iii) very low costs, (iv) flexible / beneficial investment options, and (v) low to no net policy loan costs. The effect of this strategy is to potentially permanently prevent investment earnings from ever being taxed, while providing a valuable LI death benefit and some level of asset protection (depending on state law and how owned). In essence, about 10 years or so after funding, this strategy could provide the equivalent of having funded a huge Roth IRA type fund without the Roth IRA funding limitations. For those with significant funds available for long-term savings, this strategy could prove to be very beneficial, especially for higher income taxpayers.
- G. **Captive Insurance Companies.** Captive insurance companies that are conservatively structured and administered could prove to be a very beneficial way for a high earning business entity to cover its business risks. The benefits come from a combination of (i) the legal ability for companies to avoid income tax on income used to cover the risk of future covered losses, (ii) this can be done by utilizing a related party insurance company, (iii) the related party insurance company has a beneficial tax profile, and (iv) any assets which eventually are determined not to be needed can be used to effectively benefit the business owner and his or her family. In other words, properly and conservatively structured and administered, this strategy enables a business to cover real business risk in a potentially very beneficial manner from a tax perspective and any assets not eventually deemed needed for this purpose can be returned to benefit the business owner. When done properly, it can be a huge win-win, but if the structure and / or administration deals fast and loose with the legal requirements, the business and



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its owners could be in for a shock when the IRS comes knocking. This strategy is for business owners with fairly consistent high net income and are willing to deal with the fairly expensive set up and on-going administration costs.