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**That Life Insurance Policy May Be Worth More
Than You Think!**

Donald O. Jansen

Author Contact Information:
Donald O. Jansen
The University of Texas System
Austin, Texas

djansen@utsystem.edu
512-499-4493

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Donald O. Jansen

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF CONTENTS	i
I. SCOPE OF ARTICLE AND INTRODUCTION	1
II. TYPE OF LIFE INSURANCE POLICIES PRIMER	1
A. TERM POLICIES	1
1. Annual Renewable Term	1
2. Level Term Insurance	2
3. Group Term Insurance	2
B. PERMANENT INSURANCE	2
1. Whole Life Policies	2
2. Single Premium Limited Pay Policies	3
3. Traditional Universal Life Policies	3
4. Indexed Universal life Policies	4
5. Variable Universal Life Policies	4
6. Secondary Guarantee – No Lapse Guarantee Policies	5
C. REFERENCES	5
III. VALUE OF LIFE INSURANCE POLICY FOR GIFT TAX PURPOSES	6
A. GENERAL RULES	6
1. Willing Buyer/Willing Seller	6
2. Actual Sale or Comparable Contract Rule	6
B. RULES OF THUMB WHEN ACTUAL SALE OR COMPARABLE CONTRACT VALUE NOT READILY ASCERTAINABLE	6
1. Value of Brand New Policy	6
2. Value of a Limited Pay/Paid Up or Single Premium Policy	6
3. Value of a Policy In Force for Some Time With Future Premiums	7
4. Existing Term Policy	8
5. Group Term Insurance	8
6. Split Dollar Insurance	9
7. Unusual Nature of the Life Insurance Contract	9
8. Life Settlement Market	10
9. Potential Impact of Revenue Procedure 2005-25 and the New Income Tax Regulations	10
IV. VALUE OF LIFE INSURANCE POLICIES FOR ESTATE TAX PURPOSES	11
A. DECEDENT OWNER NOT THE INSURED – SAME AS GIFT TAX VALUATION	11
1. Sale of Comparable Contract	11
2. Rules of Thumb When Comparable Sale Unascertainable	11
B. SALE FOR ADEQUATE AND FULL CONSIDERATION EXCEPTION TO SECTION 2035	12
1. The Three Year Rule of IRC Section 2035 and Its Exception	12

TABLE OF CONTENTS

	<u>Page</u>
2. So What is the Policy Value for a Sale for Full and Adequate Consideration?	13
V. VALUE OF LIFE INSURANCE POLICY FOR GST PURPOSES	14
A. DATE OF VALUATION OF ASSETS FOR GST EXEMPTION ALLOCATION	14
1. Value of Transfer at Death – Estate Tax Rules	14
2. Fair Market Value for Lifetime Transfers – Gift Tax Rules	14
B. VALUE AT DATE OF GST TRANSFER	16
1. Taxable GST Transfers	16
2. Taxable Termination	16
3. Taxable Distribution	16
4. Direct Skip	16
VI. VALUE OF LIFE INSURANCE POLICIES FOR INCOME TAX PURPOSES	17
A. INCOME TAX CHARITABLE DEDUCTION	17
1. Non-Life Settlement Policy	17
2. Life Settlement Policy	17
3. What is Fair Market Value?	17
B. FAIR MARKET VALUE FOR SECTIONS 79, 83 AND 402(C) purposes	17
1. Recent Regulation Amendments	17
2. Qualified Plan Distributions and Sales	18
3. Group Term Insurance With Permanent Benefits	18
4. Non-Qualified Transfers	19
5. So What Is Fair Market Value?	19
C. FAIR MARKET VALUE FOR SECTION 402(b) PURPOSES	21
1. Schwab	21
2. Lowe	22
3. Does Rev. Proc. 2005-25 Impact Schwab and Lowe	22
4. Bottom Line as to Where We Are	23

THAT LIFE INSURANCE POLICY MAY BE WORTH MORE THAN YOU THINK!

By Donald O. Jansen

I. SCOPE OF ARTICLE AND INTRODUCTION

In all types of transfers of life insurance policies, it is very important to know the value of the policy. Gift and generation skipping tax valuations arise in transfers to family members and irrevocable trusts. Value for income tax purposes is important with regard to sales of policies and transfers resulting in compensation or dividends to an employee or shareholder buy sell agreements or transfer to a partnership, corporation or LLC of which the insured is a partner, shareholder or member. Valuation can also be important for estate tax purposes when the deceased owner is not the surviving insured.

The problem is that valuation rules for income tax purposes differ in important ways from valuation for transfer tax purposes. In many cases, valuation of policies involve rules of thumb with many exceptions and no bright line valuation test.

The valuation rules often depend upon the type of life insurance policy that is involved in the transfer. Thus this outline will start with a basic primer of life insurance policies followed by an examination of the gift GST, estate and income tax valuation rules in that order.

II. TYPE OF LIFE INSURANCE POLICIES PRIMER

A. TERM POLICIES

1. Annual Renewable Term.

- a. This is a pure death benefit without cash value. The policy is renewable annually without proof of insurability. The premium increases each year with age based on underwriting classification. These policies normally have a right to convert to permanent life insurance without proof of insurability.
- b. This type of policy is best for short term needs for a younger person – income replacement or debt retirement in case of an early death of the insured. It is often used as a decreasing term rider to a whole life policy (blended insurance) to keep death benefit high at lower cost in the early years until the term is replaced by paid up additions or replaced by permanent coverage with increased premiums.

2. Level Term Insurance.

- a. The carrier guarantees a fixed term premium over a period of time in blocks of five years up to 30 years depending on the age of the insured. Since the premium is fixed, it is generally higher than an annual renewable term premium in the early years of the level term. These policies usually have a conversion to permanent life insurance feature without proof of insurability. Even if renewable at the end of the term, the premium for the renewed policy will be significantly higher.
- b. The advantage of a level term policy is that the premium is fixed for a number of years and not an annual renewable term premium subject to current carrier cost and mortality experience.

3. Group Term Insurance.

- a. This employer provided insurance is available to a group of employees without proof of insurability. The first \$50,000 of employer provided coverage is income tax free to the employee. Any excess coverage is generally taxed to the employee using the Table I rates in the regulations.
- b. A problem is that the coverage terminates upon the employee's severance from employment. Although there is a conversion to permanent insurance right upon employee severance from employment, the conversion policy premium will be very high.

B. PERMANENT INSURANCE

1. Whole Life Policies. This type of policy has the most carrier guarantees but has more expensive premiums than universal life.

- a. The premium is fixed for the life of the insured and the death benefit is guaranteed if the premiums are paid (either by the owner, policy dividends or cash value loans). A minimum cash value growth is also guaranteed. The cash value growth is low in the initial policy years in order for the carrier to recover its front-end expenses in case the policy owner surrenders the policy or lets it lapse.
- b. Thus the carrier assumes the mortality , investment return (for the guaranteed cash value), expense and lapse risks of the policy. As a result, in setting the premium, the carrier makes very conservative estimates in determining the risks. If the policy performance exceeds the conservative estimates, the cash values may exceed the guarantee and mutual carriers may pay dividends and the stock carriers may credit for larger policies, additional interest to the

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