Allianz Life Insurance Company of North America

LIFE ADVANCED MARKETS

Flexible estate planning strategies

Keeping estate goals on track through unexpected change

One key factor to keep in mind as you consider plans for transferring wealth to the next generation, or passing on the family business, is this: **Change is inevitable.**

"The only constant in life is change."
– Heraclitus

Your family dynamics may change, your personal financial needs may change, and tax laws may (and probably will) change. And there is one particular aspect of estate planning that is unique and simply unknown – the timing of when your plan will go into effect (your death). These factors can create a moving target when it comes to developing an estate plan, making it important to build in as much flexibility as possible.

Families often seek to accomplish one or more of the following with their estate plan:

- Minimize taxes (income, capital gain, estate, gift, and generation skipping taxes)
- Protect property from potential creditors (judgment creditors, bankruptcy trustees, a divorced spouse, etc.)
- Assure their estate ends up in the right hands
- Avoid family strife
- Avoid mismanagement of their estate by their heirs
- Keep the family business in the family

While there are a number of strategies for accomplishing such goals, many require that **irrevocable decisions** be made with very little ability to make modifications should

circumstances change. But there are ways to implement strategies that provide a level of flexibility, allowing families to accomplish their goals while retaining the following:

- Continued use and enjoyment of property
- Continued access to income
- The ability to control and manage property
- The ability to change future recipients of income and property

Reasons for building flexibility into your estate plan

Changes in tax laws

The current federal estate tax originated from tax laws passed in 1916 and has gone through a constant stream of changes over the past few decades. There have been attempts to repeal the tax, changes to the exemption amount, and changes to the tax rates. Since 2001, there have been three major pieces of legislation that impacted federal transfer taxes: the Economic Growth and Tax Relief Reconciliation Act of 2001; the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010; and the 2017 Tax Cuts and Jobs Act. Many of the provisions in the 2017 Tax Act relating to the estate and gift tax are **set to expire in 2026.**

There have also been multiple attempts to change other laws related to taxes impacted by death. IRC §2014 provides that when a capital asset is passed on at death, the basis in that asset is increased (or decreased) to the fair market value of the asset at the date of death – often referred to as the step-up in basis rule. This provides a tremendous advantage for the heir who may then sell the asset and recognize little or no capital gains tax. It essentially wipes out all taxable gains on the asset. This step-up in basis rule has been repealed once before and then reinstated, and there are now proposals to repeal it again.

Changes in family dynamics

Families may go through many different changes as time goes on. Some are positive – grandchildren come into the world, marriages add new family members, and family business success is achieved. Some are negative – divorce separates families, family friction creates rifts, and family members may pass away well before their time. With each change, your goals for passing on the wealth you have accumulated may change as well.

Consider the business owner with three children, all in their teens. Which child, if any, will want to take over the family business? What if the business owner decides to sell the business to a third party and the estate no longer includes a business interest? What if a grandchild is born with special needs? Would a traditional estate plan include provisions that address the unique financial needs of that child? These examples stress the importance of building flexibility into your plans.

Changes in personal financial goals/needs

Many of the more common estate planning strategies involve the transfer of wealth prior to death. These may include strategies to gift assets, sell assets, or loan funds to family members.

Before making such a transfer, families should analyze their own financial/income needs and consider how those needs could potentially change. Gifting strategies may reduce estate taxes and protect family wealth from creditors, but what if your financial needs change (business failure, economic downturn, unexpected disability) and you need access to those gifts?

There are strategies that may allow you to achieve the advantages of a lifetime transfer of wealth while retaining a level of access to the funds transferred if needed. In each of the cases, an indexed universal life insurance (IUL) policy may be used as a funding vehicle.

Flexible estate planning strategies

The following are brief summaries of strategies designed to accomplish various estate-planning goals while retaining a level of flexibility. (Please consult with your tax advisor and/or attorney to discuss your specific situation.)

Spousal Lifetime Access Trust (SLAT)

Summary of strategy	
Basic design	• The trust is owner and beneficiary of a life insurance policy covering the life of the contributing spouse. • Spouse and children are beneficiaries of the trust and may receive distributions for their health, education, maintenance, and support. • Spouse/beneficiary may choose how the trust is to be distributed, when it is to be distributed, and to whom it will be distributed after their death.
Advantages	• Assets contributed to the trust are removed from the estate and free from estate taxes. • Trust property may be protected from potential creditors. • **Spouse making contributions to the trust retains access to trust income "indirectly" through their spouse.**
Considerations	• A divorce would eliminate access to policy cash values for the contributing spouse, and leave an ex-spouse as a beneficiary of the trust. There are trust provisions that legal counsel may include to mitigate this issue. • When dual SLATs are considered, if each spouse's SLAT is identical, there is a risk the IRS may consider them "reciprocal trusts" and include the death benefits in their estates.

Standby Trust

Summary of strategy	
Basic design	• Utilizes a life insurance policy on the life of a married individual. • The spouse with the shorter life expectancy is named the initial owner, and the spouse with the longer life expectancy is the insured. • Upon the death of the owner spouse, the policy automatically changes ownership to the Standby Trust (the trust is designed specifically to achieve the family wealth-transfer goals). • The policy could be owned by a revocable Standby Trust that automatically converts to an irrevocable trust after the first spouse passes away.
Advantages	• Death benefit proceeds are not included in the estate for estate tax purposes. • **While both spouses are alive, they will have full access to policy cash values.**
Considerations	• If the spouse with the longer life expectancy (the insured) passes away first, the surviving spouse will need to consider strategies for removing the death proceeds from their estate if estate taxes are still a concern at that time.

Flexible estate planning strategies (continued)

Disclaimer Trust

Summary of strategy	
Basic design	• Life insurance policy owner is the insured. • Their spouse is named as primary beneficiary. • A disclaimer trust is named as secondary beneficiary – the trust may provide income to a surviving spouse and children. • When the insured passes away, the surviving spouse may disclaim the death benefit, which will then pass to the disclaimer trust.
Advantages	• The surviving spouse may take receipt of death benefits or disclaim them. • **While the insured spouse is alive, they will have full access to policy cash values and the right to change the beneficiary.**
Considerations	To be valid, a disclaimer must meet certain legal and filing requirements under IRC §2518.

Private Financing

Summary of strategy	
Basic design	• Life insurance policy is owned by a third party (often a family member) or a trust. • The insured loans money to the owner of the policy to pay premiums, documented by a promissory note. • Interest is charged at the appropriate applicable federal rate.
Advantages	• Premium payments made are not gifts for gift tax purposes (as long as there is a legitimate intention to repay the loan). • Promissory note terms are more flexible than commercial loans, so the lender may charge a lower interest rate than a commercial lender. • Effective transfer of wealth when interest rates are low. • **The lender retains the flexibility to forgive the loan (turning the loan into a gift), or seek repayment should they need the cash flow at a later time.**
Considerations	• If annual loans are made each year as premiums come due, the interest rate charged will fluctuate from year to year. • The loan agreement may allow the interest to accrue or it may require interest to be paid each year. • It is very important that the loan be treated as a loan by the IRS and not a gift. When considering the characterization of the transfer of funds, the IRS will look at all the facts and circumstances involved.

Private Split-Dollar

Summary of strategy	
Basic design	Similar to the private financing strategy, but instead of a loan agreement, the insured enters into a split-dollar agreement with a family member or trust. There are three different types of split-dollar agreements, each with slightly different tax ramifications: • Collateral assignment split-dollar (equity) – Family member/trust owns the policy, insured pays premiums and retains the right to receive their premium contributions back. • Collateral assignment split-dollar (non-equity) – Family member/trust owns policy, insured pays the premiums and retains the right to receive the **greater of** their premium contributions or the policy's cash value. • Endorsement split-dollar (rare) – Insured owns the policy and endorses a portion of the death benefit to the family member/trust.
Advantages	• Minimal to no gift tax exposure when premiums are paid. • Flexibility to "forgive" repayment of premiums paid. • **Potential for limited or full access to cash values.**
Considerations	• Under either collateral assignment split-dollar variations, if the insured chooses to forgive the amount they have a right to recover under the agreement, it will be considered a gift to the trust for federal gift tax purposes. • If a non-equity split-dollar arrangement is terminated prior to the death of the insured, the trust will need to pay the insured the entire cash value. If cash values are used to make the payment, the policy will need to be surrendered resulting in no death benefit for the trust. • It is important to develop a repayment strategy. When and how will the trust repay their obligation? If policy cash values will be used to repay the obligation, the policy should be properly funded and monitored. The obligation may also be repaid at the death of the insured. In this case the repayment would be paid to the insured's estate.

Clayton Qualified Terminable Interest Property Trust (QTIP)

Summary of strategy	
Basic design	• A married individual may establish a QTIP trust and use a portion of trust principal to purchase a cash value life insurance policy on their life. An alternative is to acquire a cash value life insurance policy, own it personally to retain access to cash values, and name the QTIP trust as the beneficiary. • Upon the death of one spouse, their personal representative or estate executor is given the right to allocate their estate between one of two trusts – one that qualifies for the marital deduction (QTIP), and one that does not. • Trust income from both trusts are distributed to the grantor's spouse who is the sole income beneficiary. • In the QTIP Trust, prior to their death the deceased spouse dictates who is to receive the remaining trust balance upon the death of their surviving spouse. In the non-QTIP trust, the surviving spouse is often given the power to make that decision.
Advantages	• Remaining trust balance in the QTIP is included in the surviving spouse's estate for estate tax purposes upon their death, but receives a step-up in basis (heirs may have little to no capital gain tax upon sale of the asset). • QTIPs are often considered in second marriage situations to assure children receive their inheritance. • Qualifies for the unlimited estate tax marital deduction, so no estate tax at the first death. • **Delaying decision on allocation between QTIP trust and bypass trust provides flexibility to deal with changing tax laws.**
Considerations	Conflict could arise as the surviving spouse does not retain the right to allocate their deceased spouse's estate based on their own wishes. This highlights the need for solid communication while all parties are still alive.

Trust provisions to enhance flexibility

The following are provisions that may be included in a trust to maximize the level of flexibility. It is important to discuss these options with experienced trust and estate legal counsel.

- Right to swap assets – Provides an opportunity to manage taxes.
- Limited power of appointment – Provides flexibility in choosing the amount, timing, and recipients of trust assets.
- No-contest clause – Provides a disincentive for heirs to challenge terms of the trust – protects the trust from changing family dynamics and disgruntled family members.
- Adding a trust protector – A third party who is given authority to modify certain trust provisions in order to assure the grantor's goals are met.
- Right to change trust situs – Choosing to establish a trust in certain states may provide additional flexibility to modify or terminate a trust. As state laws change, it may be advantageous to retain the right to change the trust situs.
- Decanting – The act of pouring the income and principal of a trust into a new trust with terms that better fit your changing goals (not available in all states).
- Right to change trustees – Specifically useful if a family member is named trustee. Provides flexibility should family dynamics change and the trustee is no longer acting in the best interest of the beneficiaries.

Retaining control of assets

Trusts may also be designed with a combination of the provisions above in order to allow the individual contributing assets to the trust to retain the right to continue managing those assets.

For example, a trust may be designed that allows the grantor or beneficiary to manage a family business that is owned by a trust. The trust must be carefully designed to allow such control while keeping the value of the business out of the estate for estate tax purposes and protected from potential creditors.

→ **SCAN THIS QR CODE** for more on IUL insurance in an estate planning strategy.

→ Then contact your **financial professional** to discuss your needs.

Allianz Life Insurance Company of North America does not provide financial planning services.

IUL requires qualification through health and financial underwriting.

The death benefit is generally income-tax-free when passed on to beneficiaries.

Policy loans and withdrawals will reduce the available cash value and death benefit and may cause the policy to lapse, or affect guarantees against lapse. Withdrawals in excess of premiums paid will be subject to ordinary income tax. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. If a policy is a modified endowment contract (MEC), policy loans and withdrawals will be taxable as ordinary income to the extent there are earnings in the policy. If any of these features are exercised prior to age 59½ on a MEC, a 10% federal additional tax may be imposed. Tax laws are subject to change and you should consult a tax professional.

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Allianz Life Insurance Company of North America

5701 Golden Hills Drive
Minneapolis, MN 55416-1297

www.allianzlife.com | 800.624.0197