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INSIGHT: Estate and Life Insurance Considerations During the Covid-19 Pandemic

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The Covid-19 pandemic has brought estate planning to the forefront of many people's minds. Henry Montag of The TOLI Center East and Andrea Schanker of Schanker & Hochberg walk through key considerations for life insurance and estate planning during the this unusual time.

Although we've lived through similar global pandemics, (Hong Kong Flu, H3N2 1968), with over one million global deaths, including over 100,000 in the U.S., the Internet and continuous news coverage makes it seem as if Covid-19 is the first and only time in our lifetimes that we've ever lived through a global viral pandemic of this magnitude.

While anyone under age 55 would have no recollection, many aged 55 and over may have some memory of the funny numbers and letters. Therefore, many of us have no frame of reference nor protocol to address the many medical, financial, insurance, and legal issues that need to be addressed. Are we prepared as a nation? Are we going to get sick? Are we going to recover? Are we covered for medical costs? Will we lose our cognitive faculties? Will we lose our jobs, our income, and/or our businesses? Who will take care of us or make legal and financial decisions if we do get sick? What if our client or their family member is in an assisted living facility or nursing home and is incapacitated? Who is authorized to return that person back to private care in their own home or with other family for private, safer care with less risk of the fast spreading virus than in today's traditional institutional facilities?

All of these "what if" questions are at the forefront of our clients' and their families' minds. The most common question for an attorney, CPA, CFP, or investment advisor seems to be "Is there a plan and an authorized agent for when someone needs banking done for them, to pay their bills, to run a business, to manage a stock or real estate portfolio, to analyze gifting or IRA Roth conversion alternatives, or to have someone make medical decisions if a client is ill?"

We are in an unprecedented climate, and never has there been a more fitting or necessary time to address the concept of advance planning directives for members of your clients' families, aged 18 and over. Nor is there a better time to review all existing legal, insurance, and financial plans in light of the current pandemic situation, the new regulations such as the SECURE Act (Public Law No. 116-94), the CARES Act (Pub. L. No. 116-136), as well as your clients' current needs and desires. What may have seemed like something to take care of "one day," has turned into a basic necessity that makes it essential and necessary for you to encourage your clients to *act now*. This article will provide information about what you should know about general estate planning, some of the recent legislative changes regarding retirement, estate taxation, and opportunities with life insurance and lifetime gifting to take control of your clients' current situation by removing some of the "what if's."

While no plan can remove the emotional hurt of seeing a loved one dealing with a medical or cognitive issue, we can at least assist a client and their family to handle the financial, legal, and planning aspects first, so as to avoid a **crisis** in the event a client or a family member is directly impacted by this pandemic.

CORE ESTATE PLAN

A person should use an experienced attorney specializing in estate planning for your legal needs. A good estate plan will save an immense amount of money. This is not the time to "fee-shop" as even small mistakes or oversights can impose unnecessary, yet very expensive consequences. There is no substitute for a CPA to run various financial alternatives regarding the mitigation of individual and corporate taxes as related to the SECURE Act, the CARES Act and a Roth conversion. Lastly engage an independent experienced life insurance professional to discuss and analyze the features, benefits, and the performance of the current life insurance portfolio to make certain it will be there in the future as initially intended.

Here's a common example of the new normal: Your client names two minor (under the age of 18) children as beneficiaries on their IRA/life insurance policy/bank account, and then passes away. Minors are incompetent in the eyes of the law, and title to assets may not be held in their names. In New York, this mistake necessitates an otherwise unnecessary and costly Special Surrogate's Court proceeding to have a pecuniary guardian appointed for those minors (even if the applicant is the custodial, legal guardian).

New York law, under Surrogate's Court Procedure Act Section 103(27), defines minors as individuals under the age of 18. Minors are viewed, by the law, as individuals suffering from a disability and therefore uncapable of managing their own affairs and therefore, without legal capacity. As such, they are considered wards of the court and that if they do inherit, they need protection and court supervision (*Application of A.D. in Behalf of P.D.*) Distributions to minors and the protocol for doing so is governed by several bodies of New York State law (NYS Estates Powers and Trusts Law, NYS Surrogate's Court Procedure Act, NYS Civil Practice Law and Rules, as well as the Domestic Relations Law in NYS.)

What about financial support for a disabled or special needs beneficiary that may be collecting some form of public assistance? If your client is able, they will undoubtedly take care of their child's financial needs, but "what if" they are no longer here? What if there aren't sufficient assets in the estate to provide enough financial support. That is when life insurance can best be used to fund a supplemental needs trust that assures that their child will not have to rely on family or friends to financially care for their needs. The funded supplemental needs trust is a way to provide additional financial support, over and above what Medicaid can provide without interfering with Medicaid eligibility.

CORE DOCUMENTS

Below is a list of core documents to assist your clients with the proper estate planning during these turbulent times:

Last Will and Testament: The document that directs administration of the probate estate at time of death. In New York, a primary executor (or co-executors), named in the will is formally appointed upon the issuance of letters testamentary by the surrogate's court.

Revocable Living Trust: A "will" substitute that directs for administration of the estate at time of death and avoids the requirement of probate for assets titled therein while alive or assets designating the trust as a beneficiary. The client acts as trustee while alive and has full access, control and use of any assets in the trust. An alternate trustee (or co-trustees) are named to act on the client's behalf during incapacity or upon death. While alive the taxpayer identification number is the clients Social Security number as this is considered a grantor trust. Therefore, there is no asset protection, nor is there any income tax implication. Individually owned assets are assigned to the trust or the trust is named as a beneficiary on individually owned accounts. Doing so allows a probate proceeding in the surrogate's court to be avoided. Probate avoidance is essential.

The surrogate's court as we know is currently in a "shut down" mode which significantly frustrates an already inherently delayed proceeding. For our clients, this means "frozen accounts" until the Surrogate's Court is back to full capacity with no reasonable expectation of the application being processed anytime in the near future unless the estate can prove they are in "urgent" need. Such delays can yield considerable consequences for asset management and estate administration. As described above, a good estate plan avoids Probate by using a Revocable Living Trust and proper titling of assets. This requires the assistance of an experienced estate planning attorney who can review the proper titling of assets, as well as your clients' beneficiary designations with their other financial advisors.

Durable General Power of Attorney: A critical lifetime advance directive to designate an agent to have authority to act on your behalf if you are unable to do so for yourself, for whatever reason. Now, more than ever as a result of the pandemic, is the essence of the importance of this document more clearly exemplified. Without a valid power of attorney document, the other remedy is to petition the proper state court in your jurisdiction for an appointment of a guardian. Currently, as we know, the court system is not operating at full capacity in many states.

Health Care Declaration: This is a directive that allows you to sign a living will, authorizing your release from life support after two physicians certify that you are in a vegetative or terminal state that it is irreversible with no possible chance of recovery. There is also a health care proxy where you designate an agent to act on your behalf (when you cannot) for purposes of all medical matters. It is essential that not only a client and their partner execute such a document, but it is also imperative that any family member over age 18 also execute such a document and name an appropriate health care proxy.

RETIREMENT PLANNING AND THE SECURE ACT

As of Jan. 1, 2020, the rules regarding inherited IRA's significantly changed with the passing of The SECURE Act on Dec. 20, 2019. Most extraordinary is that (with the exception of a surviving spouse and a small handful of other exempt parties), required minimum distributions (RMD's) stretched over the course of the inheriting beneficiary's lifetime are no longer possible and the balance of the retirement account (IRAs, Roth IRAs, 401ks, 403(b)s) must be entirely paid out to the beneficiary within a 10-year period. (SECURE Act, Section 401.) Having to do so will create an additional income tax liability for future generations of beneficiaries. Some of the more popular planning strategies can include converting all or a part of the proceeds of a traditional IRA to a Roth IRA to take advantage of the recent declines in asset values which will result in a reduced tax bill.

If there is a revocable IRA trust, it should be reviewed and most likely amended to adjust to this new legislation.

LIFE INSURANCE AND THE SECURE ACT

While life insurance has become the generally accepted "Best Use" strategy to offset the increased future income tax liability imposed as a result of the changes resulting from the establishment of The SECURE Act, there are several important points that must be considered. The Federal Reserve has most recently responded to the coronavirus pandemic by cutting the federal funds rate by a total of 1.5 percentage points since March 3, 2020, thereby reducing the effective rate to 0.25%. In addition, the recent stock market plunge has adversely affected many non-guaranteed universal and variable life insurance policies, further increasing the likelihood that these types of policies will have their cost of insurance (COI) increased, thus further exacerbating an already deteriorating situation, causing many more non-guaranteed policies to expire prematurely.

Despite this, life insurance will become a more visible and important planning tool as advisors and their clients realize that it is a very efficient way for children and non-spouse beneficiaries to pay their future tax liability, and a means to prevent the further erosion of their inheritance. There will be many useful, creative, and efficient new ways to use life insurance and annuities to supplement and ease the tax burden of beneficiaries. One way to offset higher taxes will be for the IRA owner to gift IRA distributions from their required minimum distributions (RMD's) to purchase sufficient life insurance to pay for the additional taxes. These additional taxes are likeltake to take place when higher income tax rates are in effect, due to the necessary bunching of distributions caused by the 10-year rule, and the fact that beneficiaries themselves will often be receiving these increased distributions during their peak earning years.

An important note regarding keeping track of the 10-year distribution rule: A 50% penalty is assessed each year an individual does not make their distributions at the end of the 10-year period. It is vital that someone keep track of the mandatory required distributions.

DIFFERING LIFE INSURANCE STRATEGIES

Some of the more popular planning strategies can include using a charitable remainder trust (CRT) to make a charity a remainder beneficiary, thereby retaining the ability to defer paying taxes beyond the 10-year period. The IRA holder can then purchase a traditional or second-to-die life insurance policy which can provide a leveraged and income tax-free death benefit back to the beneficiary to offset the value of their charitable gift.

The government is also doing its share, by making it easier for retirement accounts to be converted to a lifetime annuity through safe harbor provisions that allow employers to offer annuities inside qualified plans. Since The SECURE Act will be a major reason for many agents and brokers to recommend their clients' purchase of new life insurance and annuities, it is advisable to keep in mind that there are many different types of life insurance products, each with their own distinct features, benefits, and best uses.

Since the objective of many of these policies is to remain in force beyond the insured/IRA owners' life expectancy, it's important that these policies are of a guaranteed nature meaning that they will last well beyond the insureds life expectancy. Since the intent of the policy is to provide a maximum death benefit with minimum accumulation, a guaranteed universal life insurance strategy would be more effective than a non-guaranteed universal, indexed universal, variable, or even a whole life policy as cash value accumulation available in a whole life policy is not required. One solution could be to invest in a second to die life insurance policy which will provide a leveraged income tax free benefit to the beneficiary and can help the beneficiary offset the future increased income tax liabilities exactly when they're needed, at the death of the second spouse.

A recent case illustrates the benefits of using life insurance when planning for the next generation's needs. A couple in good health in their early to mid-70's, as a result of having to distribute 100% of their accumulated IRA by the 10th year, would cause their only daughter to incur a current tax due of approximately $400,000 upon the death of the surviving spouse. To offset this burden, it was suggested that they purchase a $400,000 second to die guaranteed universal life insurance policy, naming their daughter as beneficiary, with the $14,000 annual premium paid directly from the current RMDs of their IRA. It should be noted, however, that as a result of the current pandemic, there are currently fewer life insurance companies that will provide guaranteed life insurance coverage beyond an insured's normal life expectancy for individuals over age 70.

It's critical to help your clients understand that life insurance is a "buy and manage" asset, not a "buy and hold" asset, as many mistakenly believe. This is especially so if a decision is or was made to purchase one of the non-guaranteed life insurance policies. Keep in mind that ratings, crediting rates, and financial information, including internal costs, can and often do change, resulting in one's coverage expiring prematurely, and not being available to accomplish the wealth transfer task to the next generation it was initially intended to accomplish.

Agents and brokers under the new "Best Interest rules" (Rule 187), which just became effective Feb 1, 2020, must now provide their clients with full written disclosure of a recommended life insurance product's risks and an understanding of what it can and cannot accomplish. It is also important to communicate the varying costs for these products, as some contain guarantees and others do not. Further, some provide long-term care coverage, while others do not.

LIFE SETTLEMENTS DURING THE PANDEMIC

The life settlement market evolved in the late 1980 with the AIDS outbreak, when terminally ill individuals were liquidating assets to generate cash. Given the sellers' shortened life expectancy, investors were purchasing their life insurance policies for an amount in excess of the policy's cash value and expecting an attractive return from payment of the death benefit. Subsequently, the market became highly regulated and expanded to include older as well as impaired risk insured persons.

The problem is that the majority of clients, and many of their advisors, are not familiar with the concept of a life settlement. If a decision is made to no longer maintain their coverage, most clients either surrender the policy back to the life insurance company that initially issued the policy for its cash surrender value, or they merely stop paying the billed premium and, by virtue of default, they use up the accumulated cash surrender value until the coverage expires.

One of the major reasons for this lack of knowledge involves a profit motive for the insurance companies as they would prefer that a person, regardless of their reason for not continuing their coverage, either surrender their policy back to the insurer, or merely discontinue paying their billed premium as either option results in the insurance company keeping all of the past years paid premium while never having to pay out a death claim.

Several Insurers that maintain a career agent field force have accomplished this objective by preventing their agents from discussing the option of a life settlement with their clients under threat of terminating their agent's contracts.

This concept of "active concealment" (gag order) of the life settlement option according to an article in *Think Advisor* "is pervasive amongst life insurance carriers because surrendered and lapsed policies are key sources of profitability." ("California couple sues Lincoln National", May 5, 2014.)

As a result of the current pandemic many individuals have unfortunately found themselves in a situation where they can either no longer afford to pay the premiums on their existing life insurance policies, or they need to raise some much-needed cash to pay for other essential needs. In either situation you as their trusted advisor should make them aware of this little-known option, which may be a valuable alternative for an individual over age 70 with an adverse health issue since having purchased their life insurance policy. Let's take a look at what happens with the proceeds of a life settlement.

THE TAXATION OF A LIFE SETTLEMENT

The tax basis for a life settlement is based on premiums paid into the policy.
Any cash surrender value in excess of the basis is taxed as ordinary income.
Any value received above the cash surrender value is taxed as a long-term capital gain.

For example;	
Premiums paid	$100,000
Cash Surrender Value	$110,000
As a result	**$10,000 is subject to ordinary income**
Value of Life Settlement	$200,000
As a result	**$90,000 is subject to long-term capital gain**

Here's an example of a recent life settlement for an 82 year-old client that had a $3.5 million dollar death benefit with a $1.21 million cash surrender value. After obtaining his medical records and numerous negotiations the client obtained a $1.810 million life settlement offer from the secondary market which the client was delighted to accept.

The secondary market provides a better exit strategy for a client that finds their life insurance policy no longer affordable, no longer needed for estate tax purposes, or is perhaps required for a more immediate cash need today. While the responsibility of managing a life policy rests with the owner of an insured's life insurance policy, keep in mind that 90% of such owners are the insured, and their sons, daughters, or friends are acting as unskilled or accommodation trustees, and have no idea that this option even exists. Only 10% of policies are owned and properly managed by an institutional trustee who are well aware of this valuable option.

The Historic Opportunity to Pass Wealth with Maximum use of the Gift Tax Exemption-GIFTING

Since many asset classes have suffered a severe decline. This offers the opportunity to maximize the use of your lifetime gift tax exemption (temporarily $11,580,000 (($23,160,000 between U.S. citizen spouses) until the end of 2025). (Internal Revenue Code Section 2010(c)(3)(C), TCJA Section 11061 (effective for decedents dying and gifts made after Dec. 31, 2017, and before Jan. 1, 2026). *See* I.R.C. Sections 2010(c)(3)(B)(ii), 2503(b)(2)(B). See also Revenue Procedure 2019-44, Section 3.41 for inflation adjusted figures for the year 2020.)

Currently, the New York State Estate Tax Exemption is $5,850,000 with a top tax rate of 16%. (1 N.Y. Tax Law Section 951(a), Section 952(c)(2)(A).) The federal estate tax exemption is $11,580,000 per person ($23,160,000 between to U.S. citizen spouses). (Section 2010(c)(3)(B). See also Rev. Proc. 2019-44, Section 3.41 for inflation adjusted figures for the year 2020.) The more you use of your lifetime gift tax exemption, the less of the federal estate tax exemption will be available. That said, the lifetime gifting in our current economic environment is a home run because it removes all of that significant appreciation (increase in value) from the taxable estate.

There are many ways to "gift," but the best "bang for your buck" is to do so in a way to take advantage of a discount in the value of that already depressed-value gift. For example, a "family limited partnership" is formed so there are two classes of owners—the "general partners" and the "limited partners." You are the general partner and fund with marketable securities. You then gift a percentage of limited partnership interests to your children (outright or in trust). The marketable securities are already devalued due to the impact of Covid-19. The value of the actual gift can be further discounted because of the nature of what a limited partner is. The limited partner has no control. You, as general partner, do. A limited partner has no voting or managerial rights. The limited partners may not use their interest as collateral. For these reasons, the IRS allows for an additional discount for the value of the gift. It is a wonderful opportunity.

According to Jeffrey F. Gibralter, CPA, ABV, Partner at Klein Liebman & Gresen, LLC, as a result of the the Covid-19 pandemic, the valuations of small- to mid-sized closely held businesses have been significantly affected. Based on the public financial markets, current valuations are down from where they were towards the beginning of 2020. For business owners that have been considering gifting opportunities, now may be a unique window of opportunity where business valuations are reduced thereby providing a more favorable tax climate. If your plan involves gifting an interest in a closely-held entity, the gift needs to be supported by a credible independent business valuation.

Intra-Family Loans

Historically low interest rates mean that there is an opportunity to do intra-family loans. Proceeds then can be applied to an investment opportunity. It is an "arbitrage" through which parents can lend assets to their children. You apply the applicable federal rate of interest (for May that was 0.25% if the term is for three or less years, for June that is now 0.18%). (Rev. Rul 2020-11, Rev. Rul 2020-12.) Your children can invest otherwise and either you can forgive the loan or extend it. People with existing intra-family loans should review with their estate planning attorney to explore perhaps a refinance.

Guidance to Adhere to

This is the time to act. It is not merely a consideration, it is a call to action, an action of necessity. In New York, Governor Andrew Cuomo issued executive orders authorizing virtual notarization and virtual witnessing during the duration of this pandemic. (Executive Order 202.7, issued by Governor Cuomo on March 19, 2020, provided protocol for virtual notarization and Executive Order 202.14, issued by Governor Cuomo provided protocol for virtual witnessing. Each have been granted temporary extensions. The most recent Executive Order was issued on June 6, 2020, and provides an extension until July 6, 2020.) Many firms currently have these capabilities and have been performing these services however it is essential that once it is safe, clients should return and execute documents in the traditional manner. Most cannot wait for that time, which is what makes the virtual services imperative so that something is in place "just in case" it becomes necessary. That said, the recommendation to come back and re-execute documents pursuant to statutory protocol is to ensure these documents are honored in the re-adapted back to normal society we will one day hopefully soon return to.

In conclusion as we navigate through these unprecedented times to assist our clients with their planning it's important that we encourage them to have their planning and advisor support in place so its functional and 'ready to go' if needed.

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