Golden Bullets

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UNANSWERABLE TAX QUESTIONS:

THINGS TO CONSIDER

Like most financial professionals, we get asked tax questions all the time. Those who sell life insurance and annuities for a living get used to answering the recurring questions, such as:

- Can I ***deduct the premium*** for my life insurance policy?
- Is the ***transfer*** of my nonqualified annuity ***income taxable***?
- How can I structure my ***life insurance*** so the death benefit will be ***estate tax free***?
- What are the tax consequences of having my life policy become a modified endowment contract (MEC)?

Most of the time those kinds of questions are simple to answer. Sometimes, the questions are more complicated. Complicated or not, most tax questions related to the life insurance and financial planning business do have definite answers.

Unfortunately, some do not. Here are a few examples:

1. ***Value of Life Policy for Gift Tax Purposes When Insurability Has Deteriorated.*** The IRS has published regulations about how to value a life insurance policy for gift tax purposes when the policy is transferred. The rules are easy to interpret and understand if the insured is healthy, and the transfer occurs shortly after the policy has been purchased. The rules do not give helpful, specific valuation guidance when the insured's health has deteriorated after the start of coverage.

2. ***Section 1035 Exchange Taxable Boot in Step Transaction.*** Section 1035 of the Internal Revenue Code allows one life insurance policy to be exchange for another income tax-free. However, if the policy owner receives anything of value as part of the exchange—like cash or loan forgiveness—then the taxpayer recognizes a taxable event. The IRS has said that if a person receives something of value just prior to doing a Section 1035 exchange, it is also a taxable event. What does "just prior" mean? Is it 10 days, 60 days or six months? The IRS hasn't said.

3. ***Complete Rollover of IRA in the Middle of Section 72(t) Distributions.*** If a person takes a distribution from a traditional IRA prior to age 59 ½, the person usually must pay both income tax and an extra 10 percent penalty tax on the amount distributed. The IRS recognizes a special exception to the extra penalty tax if the taxpayer takes substantially equal distributions from the IRA based on the taxpayer's life expectancy. The special exception is lost if the taxpayer rolls over ***part*** of the IRA before completing the substantially equal distribution strategy. What if the taxpayer rolls over the whole account during substantially equal distributions? The rules aren't clear if that's OK or not.

The list of things a financial professional must know about in order to provide good help to clients is pretty long. Expertise is required in various disciplines, including with regard to choice of financial products, company practices, client objectives, alternative approaches to solving family problems and conducting business.

The financial professional is also required to be something of a tax expert who works in close conjunction with his best clients' CPAs.

What does an advisor team do when there is no final tax answer? In ambiguous situations, we will work together with your CPA to explain the nuances in a way that you can understand, and, working together, all of us will settle on a way forward that all members of the team—you, your tax advisor, your attorney, and your planners—are comfortable with.

Do you have tax questions? Let's figure out whether they are answerable or not.

AS ALWAYS, PLEASE FEEL FREE TO CALL TO DISCUSS THESE OR OTHER FINANCIAL SECURITY ISSUES OF CONCERN.

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