LIFE INSURANCE – 18 OF MY "FAVORITE" PLANNING MISTAKES YOU SHOULD AVOID AT ALL COSTS

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1. Creating phantom income by surrendering a policy (or letting a policy lapse) which was subject to an outstanding loan.

2. Borrowing against or withdrawing from a modified endowment contract (a “MEC”), or using such a policy as collateral for a third party loan.

3. Surrendering a participating policy without checking the effect of dividends received or other non-taxable distributions on the owner's investment in the contract.

4. Calculating the amount and character of the gain on a policy sale in the settlement market.

5. Determining adequate and full consideration for the sale of a policy to an ILIT to avoid the three year rule of Section 2035.

6. Transferring a policy from the insured to a third-party owner (such as an ILIT) without obtaining the policy's gift tax value from the carrier, in advance.

7. Transferring a policy during the insured's lifetime without considering the transfer for value rule and its exceptions.

8. Planning around Section 677(a)(3) if an ILIT is intended to be a non-grantor trust or is planned to be a grantor trust in a way that can be “turned off” if needed.

9. For ILITs with Crummey withdrawal powers, not drafting the ILIT so that the Crummey power is triggered by both direct and indirect premium gifts to the ILIT.

10. Failing to recognize that most policies are “buy and manage”, not “buy and hold” financial assets.

11. Post-Final Regulation loan regime split-dollar arrangements that don’t state adequate AFR interest, which are treated as term loans, especially those involving gift term loans.

12. Terminating a private pre-Final Regulation economic benefit, collateral assignment split-dollar arrangement without considering the risk that any policy equity on termination would be a transfer for transfer tax purposes.

13. Changing a pre-Final Regulation equity, collateral assignment private split-dollar arrangement without considering whether it could be considered a “material modification” of the arrangement.

14. Creating a non-equity, economic benefit collateral assignment split-dollar arrangement after the Final Regulations which isn't either a donor/donee nor a service provider/service recipient arrangement.

15. Failing to review and manage private split-dollar arrangements, especially pre-Final Regulation economic benefit arrangements.

16. Termination of a compensatory pre-Final Regulation split-dollar arrangement which doesn't consider and plan for the potential income and gift tax consequences of "policy equity" under Notices 2002-8 and 2007-34.

17. Not having amended compensatory pre-Final Regulation equity split-dollar arrangements to comply with the requirements of Section 409A and Notice 2007-34.

18. Failing to manage compensatory split-dollar arrangements, especially pre-Final Regulation economic benefit arrangements.