Planning for the Estate Tax Exemption Sunset

John Hancock

Estate Tax Planning

History of the Estate, Gift, and GST Tax: Looking at the past

1916

Modern Estate Tax

The Revenue Act of 1916 in response to the costs of World War I. Rates ranged from 1% to 10% and estate had exemption of $50,000

1924

Gift Tax

Federal gift tax enacted to prevent avoidance of the estate tax (the gift tax was repealed in 1926 and then reinstated and made permanent 1932)

1930s

Optional valuation date

Various changes to the estate tax system, including introduction of an optional valuation date election

1940s

Marital deduction

Various legislation enacted, including first version of marital deduction

1976

The Tax Reform Act of 1976

Overhauled the system by combining separate estate and gift tax exemptions into one, unified estate and gift tax credit. There was also an increase in from $60k to $120k

1981

ERTA

Economic Recovery Tax Act of 1981 expanded martial deduction, and saw decrease in top rates gradually decrease from 70-55%.

1997

The Taxpayer Relief Act

Introduced an incremental increase of unified credit, and introduced inflation indexing

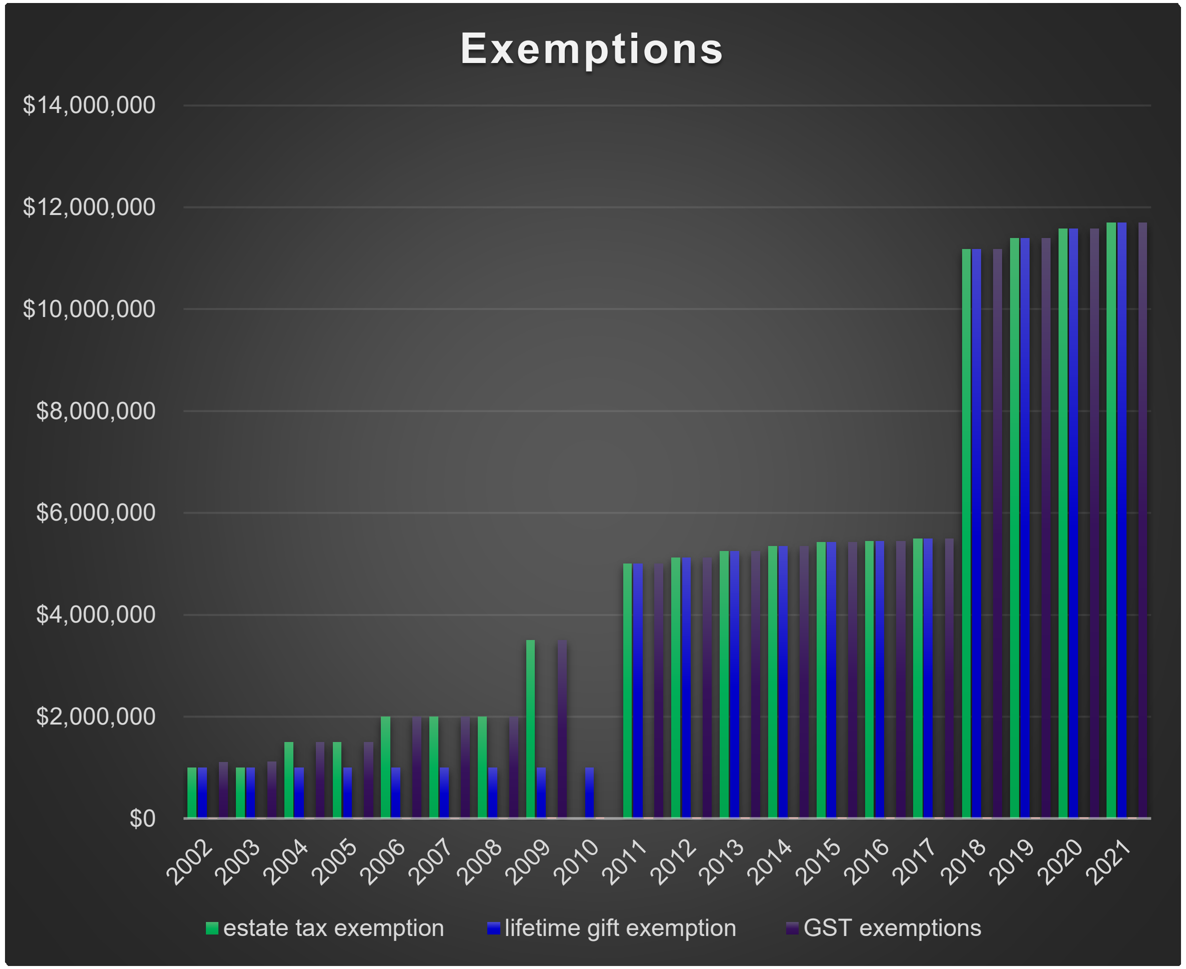
2001

EGTRRA

Economic Growth and Tax relief Reconciliation Act provided extensive changes in the system

Looking at the past

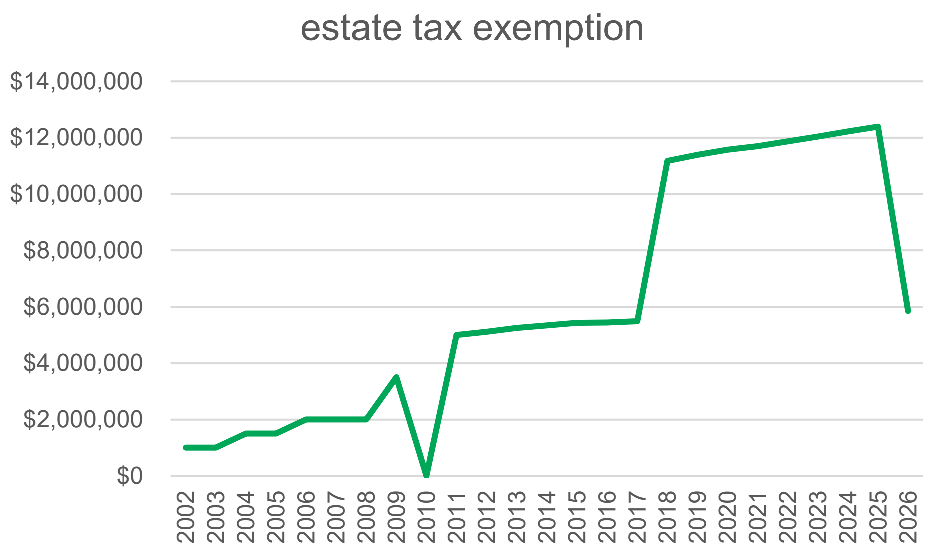
Year	Top estate tax rate	estate tax exemption	lifetime gift exemption	annual exclusion gift	GST exemptions
2002	50%	$1,000,000	$1,000,000	$11,000	$1,100,000
2003	49%	$1,000,000	$1,000,000	$11,000	$1,120,000
2004	48%	$1,500,000	$1,000,000	$11,000	$1,500,000
2005	47%	$1,500,000	$1,000,000	$11,000	$1,500,000
2006	46%	$2,000,000	$1,000,000	$12,000	$2,000,000
2007	45%	$2,000,000	$1,000,000	$12,000	$2,000,000
2008	45%	$2,000,000	$1,000,000	$12,000	$2,000,000
2009	45%	$3,500,000	$1,000,000	$13,000	$3,500,000
2010	0%	$0	$1,000,000	$13,000	$0
2011	35%	$5,000,000	$5,000,000	$13,000	$5,000,000
2012	35%	$5,120,000	$5,120,000	$13,000	$5,120,000
2013	40%	$5,250,000	$5,250,000	$14,000	$5,250,000
2014	40%	$5,340,000	$5,340,000	$14,000	$5,340,000
2015	40%	$5,430,000	$5,430,000	$14,000	$5,430,000
2016	40%	$5,450,000	$5,450,000	$14,000	$5,450,000
2017	40%	$5,490,000	$5,490,000	$14,000	$5,490,000
2018	40%	$11,180,000	$11,180,000	$15,000	$11,180,000
2019	40%	$11,400,000	$11,400,000	$15,000	$11,400,000
2020	40%	$11,580,000	$11,580,000	$15,000	$11,580,000
2021	40%	$11,700,000	$11,700,000	$15,000	$11,700,000
2022	40%	$12,060,000	$12,060,000	$16,000	$12,060,000
2023	40%	$12,920,000	$12,920,000	$17,000	$12,920,000



Current law under Tax Cuts and Jobs Act

Lifetime Exemption

- Today 2024: $13,610,000 is the lifetime exemption
- Tomorrow -2025: This will continue to increase with inflation
- Jan 1, 2026 the TCJA will sunset/expire the estate tax will revert back to $5M (indexed for inflation)



Other Provisions Sunsetting

- Personal Exemptions, Deductions & Tax Brackets
- 199A Pass-Through deductions
- SALT Cap

*irs.gov

Will it happen?

#1 question I'm hearing – will the sunset actually occur?

Historically, once it's increased, it doesn't decrease

- Other provisions sunsetting (199A, individual income tax provisions) with broader impact
- Political landscape
- Economic landscape

What's the big deal?

Back of the napkin math

Single Individual	2024	Dec 31 2025	Jan 1 2026
Estate value	20,000,000	22,417,907*	22,417,907*
Lifetime exemption	13,610,000	15,006,221**	7,720,000**
Taxable estate	6,390,000	7,491,059	14,777,280
Tax rate	40%	40%	40%
Estate tax (est.)	2,556,000	2,996,424	5,910,912

*Assuming 5% estate growth
** Estimated (5%) estate exemption

Result? → Uncle Sam gets $2.9M more in taxes overnight

Story doesn't end there…

- Appreciation outside estate
- Liquidity needs – tax bill due 9 months after date of death
- Creditor protection
- Tax laws are unpredictable
- Changes in health

This is a hypothetical example for illustrative purposes only.
*Life expectancy based on Valuation Basic Table 2015. Life expectancy, in this example, is measured from current age 65.

Estate Liquidity Planning

Planning for Estate Taxes

Government provides tax-free exemptions & exclusions before transfer taxes apply

The *Use It or Lose It* government exemptions & exclusions:

- Unlimited marital deduction
- Unified lifetime transfer tax exclusion amount
- Charitable deduction
- Annual exclusion gifts
- Generation Skipping Transfer Tax exemption

40% Estate Tax over lifetime exemption

Options to pay any remaining estate tax liability:

- Cash/Savings
- Asset Sale
- Life Insurance

Reduction vs. Payment Techniques

Estate Tax Reduction Strategies

Estate Tax Payment Strategies

Life Insurance can be a useful tool when used in connection

Two options

Jump in!
Make the gift

Test the waters
Leverage a financing technique

Why consider a financing option?

A financing technique can help if:

- Client would like to take a “wait and see” approach on gifting
- Client does not want to liquidate or give up control over assets
- Comfortable with using leverage to purchase assets
- Gift exemptions have been exhausted or are earmarked for other planning purposes

Financing Options

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Financing options at a *glance*

This chart summarizes some of the financing options available to fund a large life insurance need.

	Private financing	Sale to an intentionally defective grantor trust	Commercial premium financing	Dual loan	Private split dollar
Lender	Grantor or Trust or Family Member	Grantor	Third Party Lender	Institutional Lender and Grantor	Grantor or Trust or Family Member
Borrower	ILIT	ILIT	ILIT	ILIT	ILIT
Description	Loan technique that offers flexibility in plan design and requires Grantor to have cash available.	Sale technique that requires income producing and/or appreciating assets.	Approved third-party lender provides loan to ILIT for purchase of life insurance.	Combines different loan arrangements (private and institutional loans) to minimize loan interest cost and offer flexibility in plan design.	Grantor pays premium on behalf of ILIT and ILIT owes greater of cash value or premiums paid.
How It Works	Grantor loans cash to ILIT to provide liquidity to pay for large premiums.	Grantor sells income producing assets to IDGT[2] in exchange for a promissory note. Trustee uses income to purchase life insurance.	Third-party lender loans the premium to the ILIT to provide liquidity to pay large premiums.	Combination of institutional loan to Grantor and a private finance loan between Grantor and ILIT.	Grantor as lender provides liquidity to the ILIT to pay large premiums on needed policy.
Annual Cost of Financing/ Interest Rate	Applicable Federal Rate (AFR)	Applicable Federal Rate (AFR)	SOFR + spread (typically)	Rates linked to each type of loan arrangement (typically combination of institutional loan rate and AFR).	Economic Benefit costs (annual term costs or Table 2001 rates).
Potential Gift Tax Impact (often associated with Interest Due)[1]	Generally, Grantor makes gifts to the trust to pay the interest due. If Grantor makes a lump sum loan upfront, trust may be able to pay the interest without requiring gifts from Grantor.	No gift required other than the initial "seed" gift. Interest payments received on the note are not income taxable to Grantor.	Grantor gifts the interest due to ILIT. ILIT pays interest to lender. May be subject to gift tax if above exemption.	**Private Finance Loan:** If lump sum, ILIT has assets to pay interest to Grantor; no gift necessary. **Institutional Loan:** Grantor pays lender interest directly; thus, gifting is not needed.	Economic Benefit cost is a gift to ILIT and requires gifting, thus might be subject to gift taxes, especially in later years.
Benefits	Flexibility in plan design based on client resources. Can be designed to either preserve gifting (if available) or avoid gift and transfer taxes (if gifting is not available).	Estate freeze for assets that are expected to appreciate significantly, income and gift tax efficiency.	No need to liquidate taxable assets to fund liquidity needed for premiums. Can be designed to either preserve gifting (if available) or avoid gift and transfer taxes (if gifting is not available).	Minimizes gift taxes and reduces the need to liquidate taxable assets to fund premiums.	Generally requires limited gifting, especially because Economic Benefit costs in earlier years are typically lower than AFR.
Collateral	Not required but often advisable; policy may be used.	Not required but often advisable.	Policy and/or other liquid assets. Grantor may have to provide personal guaranty.	Collateral requirements of institutional lender.	Policy

1. GST exemption should be allocated to gifts of interest/Economic Benefit (to avoid potential GST tax impact). • 2. Intentionally Defective Grantor Trust. • **For agent use only. This material may not be used with the public.** • This material does not constitute tax, legal, investment or accounting advice and is not intended for use by a taxpayer for the purposes of avoiding any IRS penalty. Comments on taxation are based on tax law current as of the time we produced the material. All information and materials provided by John Hancock are to support the marketing and sale of our products and services, and are not intended to be impartial advice or recommendations. John Hancock and its representatives will receive compensation from such sales or services. Anyone interested in these transactions or topics may want to seek advice based on his or her particular circumstances from independent professionals. • Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds. There can be costs associated with drafting a trust. • Insurance products are issued by: John Hancock Life Insurance Company (U.S.A.), Boston, MA 02116 (not licensed in New York) and John Hancock Life Insurance Company of New York, Valhalla, NY 10595. • LIFE-7230WEB 7/23 MLINY062323223-1

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Financial Benefits of Life Insurance

Competitive rate of return on death benefit

Life insurance provides a competitive rate of return on death benefit

Common objections

- Healthy clients may feel they don’t need life insurance.
- They may choose to invest premium dollars in other asset classes.

These clients are often surprised at the possible investment returns of a life insurance policy.

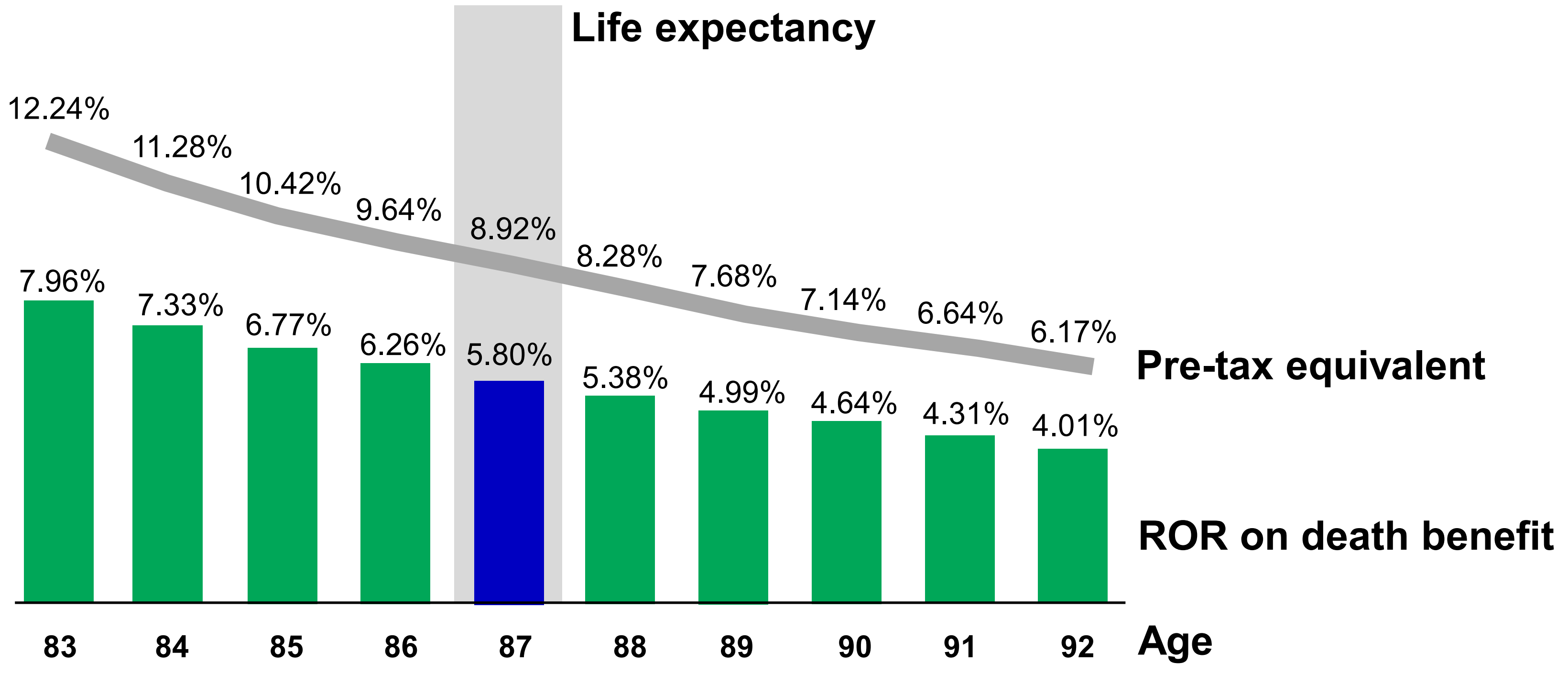
Invest in your life

Protection UL ’22, Initial face amount of $1,000,000
Male. Age 60, Preferred non-smoker

Year	Age	Planned premium	After-tax withdrawals and loans	Net outlay	Net death benefit	ROR on death benefit	Pre-tax equivalent	Probability of death (EOY)
1	61	15,299	0	15,299	1,000,000	6436.37%	9902.12%	0.14%
5	65	15,299	0	15,299	1,000,000	102.55%	157.77%	1.12%
10	70	15,299	0	15,299	1,000,000	32.89%	50.60%	3.98%
15	75	15,299	0	15,299	1,000,000	16.95%	26.08%	9.83%
20	80	15,299	0	15,299	1,000,000	10.30%	15.85%	20.63%
25	85	15,299	0	15,299	1,000,000	6.77%	10.42%	38.54%
27	**87**	**15,299**	**0**	15,299	1,000,000	**5.80%**	**8.92%**	**47.66%**
30	90	15,299	0	15,299	1,000,000	4.64%	7.14%	62.81%

*Life expectancy based on Valuation Basic Table 2015. Life expectancy, in this example, is measured from current age 60.
-The IRR on death benefit is equivalent to an interest rate at which an amount equal to the illustrated premiums could have been invested outside the policy to arrive at the net death benefit of the policy
-This is a supplemental illustration. Not all benefits and values are guaranteed. The assumptions on which the non-guaranteed elements are based are subject to change by the insurer. Actual results may be more or less favorable.

Summary



By the age of 87 (life expectancy), there is a 47.66% probability that he will have died.

- His investment must have earned 5.80% **after-tax** to have earned enough to equal the death benefit,

or

- His investment must have earned 8.92% **pre-tax** (assumes 35.00% income tax rate).

If he adds the Long-Term Care rider, his premium increases by less than 10% with an after-tax ROR on death benefit of approximately 5.23% at life expectancy.

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Underwriting Solutions*

Large case capability

- *Up to $30M Retention (single life) or $35M (survivorship)*
- *Up to $65M Jumbo*
- *$100M+ Facultative Obligatory*

Concierge Underwriting

- $5M up to $65M
- Ages 35-70
- Household net worth 10M+
- No Labs
- Exam within 18 months (35-50)
- Exam within 12 months (51-70)

* Policy issuance is not guaranteed as any life insurance purchase is subject to completion of an application, including health questions, and underwriting approval. John Hancock may obtain additional information, including medical records, to evaluate the application for insurance; and after the policy is issued, to identify any misrepresentation in the application.

Predicting taxes is like predicting the weather

Remember

- There is no crystal ball for tax law
- Recent proposals could come back
- Current “Use it or Lose It” scenario
- Competing macroeconomic priorities
    - Inflation, trade, climate, etc.
- Tax laws are always a hot-button topic
- HNW clients will continue to need tax-advantaged solutions for income and legacy planning

Mitigating transfer costs through planning enables clients to increase what beneficiaries receive.

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Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.

Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59 1/2.

Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds. There can be costs associated with drafting a trust.

Insurance policies and/or associated riders and features may not be available in all states. Guaranteed product features are dependent upon minimum premium requirements and the claims-paying ability of the insurer.

Some riders may have additional fees and expenses associated with them.

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