Life Advanced Markets Intel
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Strategic Insights

from David Foster, Senior Director of Advanced Markets

With his ongoing LinkedIn series, David keeps you up to date on trends and opportunities for fixed index universal life insurance in estate planning strategies, taxation, business strategies, and more.

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This month's topics (click on each to read)

ADVANCED MARKETS STRATEGIES

- **Inflation Reduction Act increases IRS scrutiny | 9.15.22**
- **An upside to inflation? Substantial increases in the estate/gift tax exemption (for now) | 10.20.2022**

Inflation Reduction Act increases IRS scrutiny | 9.15.2022

- **The Inflation Reduction Act includes an additional $80 billion of IRS funding over the next 10 years.**
- **Given this funding, financial professionals who work with affluent clients should be aware that audits will likely increase.**
- **The tax advantages of cash value life insurance may become even more appealing in the coming years. However, aggressive strategies are more likely to face IRS scrutiny.**
- **Always work with tax and legal professionals who are experienced with the unique tax laws applicable to cash value life insurance.**

As the famous Spider-Man quote says, "With great power comes great responsibility." But the IRS will soon have its own version of that phrase – "With great income comes great scrutiny."

The Inflation Reduction Act, signed by President Biden on August 16, included an additional $80 billion of funding to the IRS over the next 10 years. Those funds include $46 billion to tax enforcement, $25 billion for IRS operations, $5 billion for business systems modernization, and $3 billion for taxpayer services. While this has caused a rather predictable political reaction and uncertain predictions of additional revenue collected, etc., you have to admit – that's a lot of additional funding for enforcement.

Who should expect to be a target of all the additional enforcement efforts? An IRS press release in April of 2021 that discussed the need for additional IRS funding referred to a study by the National Bureau of Economic Research on the topic of under-reported income in the U.S. – Tax Evasion at the Top of the Income Distribution: Theory and Evidence. That study concluded that, "under-reported income as a fraction of true income rises from about 7% in the bottom 50% of the income distribution to 21% in the top 1%. Out of this 21%, 6 percentage points correspond to sophisticated evasion that goes undetected in random audits."

Drilling down even deeper, of the total taxable income that was under-reported by the top 1%, the largest percentage (35%) came from Schedule C income (generally income of a C corporation), followed by income from partnerships and S corporations (18.9%) and capital gains (18.8%).

While the funding for the additional enforcement efforts will trickle out over a period of 10 years, financial professionals who work with affluent clients should be aware that audits will likely increase. In addition, the IRS, who has typically lacked the needed in-house expertise, should be better equipped to analyze complex financial and tax strategies.

A word of caution: There are many tax advantages that apply to cash value life insurance, and there are many ways to use cash value life insurance to accomplish estate and business goals for high-net-worth clients. With the additional IRS scrutiny, these tax advantages may become even more appealing. However, aggressive strategies are more likely to face IRS scrutiny in the coming years. Always work with tax and legal professionals who are experienced with the unique tax laws applicable to cash value life insurance.

Learn more about advanced markets strategies.

An upside to inflation? Substantial increases in the estate/gift tax exemption (for now) | 10.20.2022

- **Based on CPI-U inflation data, the IRS has raised the federal estate/gift tax exemption amount for 2023 to $12,920,000 per person ($25,840,000 per married couple). That means a married couple will have the ability to gift an additional $1,720,000 free of federal gift taxes.**
- **Without legislative action, the exemption amounts are scheduled to revert back to previous levels (roughly half of the current levels) at the end of 2025.**
- **Strategies for taking advantage of the additional gift tax exemption levels include private split-dollar and private financing life insurance arrangements, grantor retained annuity trusts (GRATs), and pre-funding irrevocable life insurance trusts (ILITs).**
- **Now might be a good time to start discussion with high-net-worth clients on their wealth transfer goals and how the increased exemptions may be used to help accomplish them.**

Not to sound like a Pollyanna, but amid all the downsides of current inflation, there is at least one positive development.

In Rev. Proc. 2022-38, the IRS announced that, based on inflation data (specifically the CPI-U), the federal estate/gift tax exemption amount for 2023 will increase by $860,000 to $12,920,000 per person ($25,840,000 per married couple). That means a married couple will have the ability to gift an additional $1,720,000 in 2023 free of federal gift taxes. In addition, the annual gift tax exclusion will increase to $17,000 per donee ($34,000 per married couple).

Based on sunset provisions in the Tax Cuts and Jobs Act, the exemption amounts are scheduled to revert back to previous levels at the end of 2025 (roughly half of the current levels) absent legislative action.

For advisors concerned about clawback, on November 26, 2019, the IRS clarified that individuals taking advantage of the increased gift tax exclusion amount in effect from 2018 to 2025 will not be adversely impacted after 2025 when the exclusion amount is scheduled to drop to pre-2018 levels.

There are numerous strategies for taking advantage of the additional gift tax exemption levels. Consider the following:

1. Private split-dollar and private financing life insurance arrangements – In 2023 you may forgive an additional $1.72 million of the amount the "borrowing" party owes the "lending" party.
2. A grantor retained annuity trust (GRAT) may provide a gift-tax-favorable means of transferring wealth. Many GRATs are designed to be zeroed-out (i.e., value of the retained annuity interest is equal in value to the projected remainder interest). With the exemption level higher in 2023, you don't need to make it a zeroed-out GRAT. The annual payments from the GRAT back to the grantor may be used to pay life insurance premiums.
3. Pre-funding irrevocable life insurance trusts (ILIT) – Gift up to $1.72 million to an ILIT, have the trustee contribute a portion to the first year premium and the remainder to a premium deposit fund (PDF). The PDF will automatically transfer subsequent annual planned premium payments into the policy.

These are just a few ideas for using the increased gift tax exemption amount in 2023. Now might be a good time to start discussion with high-net-worth clients on their wealth transfer goals and how the increased exemptions may be used to accomplish them.

Learn more about how life insurance can be a potential solution

For help in leveraging our Advanced Markets Intel to grow your business, contact the **ADVANCED STRATEGIES AND PLANNING PLATFORMS TEAM**, 800.800.3220 or AdvancedStrategies@allianzlife.com.