ADVANCED PLANNING

bulletin

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Charitable Planning

- With Life Insurance 02

Employer-Owned Insurance

- New Guidance....................................04

Brief Summaries of other planning and legal developments 06

- Deferred Compensation
- STOLI

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The Private Foundation Charitable Life Insurance Plan

Case Facts

Bill Charitable, age 46, believes that his present net worth of $16 million is "more than enough" for his wife and children. He wants to protect his family but he does not want to spoil his children. Bill and his wife, Mia, are very charitable in their community, and he would like to help charities after his death.

In order to preserve and transfer his $16 million estate to his wife and children, an irrevocable life insurance trust will own an $8 million survivorship life insurance policy. Bill would also like to purchase a cash value life insurance policy on *his* life. He wants to be the sole owner of it so he can access the cash value. He wants the death benefit to pass to a charity. He likes the idea of providing a large charitable gift at the smaller cost of the premiums.

Using Life Insurance to Meet the Bill's Personal and Charitable Needs

Bill can own the life insurance policy and name a charity as the beneficiary. Bill gets to control the policy, his family does not get more assets and he benefits a charity. If Bill would like his family to have a more hands-on approach for the charitable piece, Bill can establish a private family foundation and name the foundation as the beneficiary of his life insurance policy.

Either way, Bill gets to control the policy (e.g., the right to borrow from the cash values and the right to receive the dividends in cash), Bill's family does not get more assets, and Bill is benefitting a charity. So, what extra benefit does he get with a private foundation?

Non-Tax Benefits of the Private Foundation

1) Bill and Mia can have a foundation named after themselves.

2) Lifetime contributions made to the foundation can be distributed to various charitable organizations while Bill and Mia are alive.

3) After Bill's death, the foundation receives a significant amount of capital (i.e., the death proceeds) to fund its charitable purposes.

4) After Bill's death, his children, as directors of the foundation, can continue the family's legacy of largess for the community.

5) The insurance proceeds allow the foundation to have a significant charitable impact on the community for many years to come.

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Tax Results

Because Bill owns the policy, he does not receive any charitable income tax deduction for his premium payments. This is the trade-off for his control of the policy. At death, the death proceeds are included in his estate; however, his estate receives a charitable estate tax deduction equal to the death proceeds.

Final Thoughts

The beauty of these options for those who are charitably inclined: control of the life insurance policies, flexibility to allow for a change of mind, and a large charitable bequest – in other words, they can have their cake and eat it too.

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New Guidance on Employer-Owned Insurance
Notice 2009-48, 2009-24 I.R.B. 1085

This Notice, written in question and answer format, provides answers to many questions about employer-owned life insurance under § 101(j).

Section 101(j) provides that death benefits paid under employer-owned life insurance policies issued after August 17, 2006 are income taxable, unless (1) the insured is an employee within a specified category, (2) the employer notifies the employee that it intends to purchase life insurance on the employee's life payable to the employer, indicating the maximum face amount of such coverage, and (3) the employee consents in writing to the coverage. *See Advanced Planning Letter* No. 181 (September 2006).

Highlights of Notice 2009-48 include the following:

- **Employer-owned**. Policies owned by business owners to fund a cross purchase buy sell do not require notice and consent. Only policies that are owned by an employer are subject to the notice and consent rules. This includes an employer-owned policy subject to a split dollar endorsement agreement.

- **Date of issue**. Notice and consent requirements must be satisfied before the policy is "issued." This is deemed to be the later of (1) the date of application for coverage, (2) the effective date of coverage, or (3) the formal issuance of the policy. It is still good practice to have the notice and consent completed at time of application. As an aside, the notice and consent may be electronic.

- **Transfer of policy to employer**. Existing policies owned by the insured employee which are transferred to the employer do not require notice and consent. In this situation, notice and consent requirements are satisfied by virtue of the employee's transfer.

- **Duration of consent**. Employee consent to the purchase of a new policy generally remains valid for up to one year. Once the policy is purchased, no renewal of notice is required, although subsequent face amounts which exceed the original notice require a new consent.

- **Relief for inadvertent failure**: The IRS will not challenge inadvertent failures to meet the notice and consent requirements if (1) the employer made a good faith effort to satisfy those requirements, such as by maintaining a formal notice and consent system; (2) the failure was inadvertent; and (3) the failure was discovered and corrected by the employer's tax return due date for the year in which the policy was issued. This relief is very helpful and gives us some idea as to what is meant by "good faith effort." In fact, employers should consider adopting a formal notice and consent procedure so this optional relief is available if needed, but nonetheless should strive to follow the notice and consent requirements prior to policy issuance.

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- **Maximum amount of coverage**. The employee must be notified of the actual maximum face amount of life insurance, expressed either as a dollar amount or multiple of salary. Using the words "the maximum face amount for which the employee could be insured," will not work. This maximum face amount is the amount the employer reasonably expects to buy while the insured is employed. A single consent can cover multiple policies, as long as the notice and consent relate to the maximum aggregate death benefit.

- **Material changes**. A policy will be treated as newly issued if there is a material increase in the death benefit under an existing policy or other material change. Death benefit increases due to dividends purchasing paid up additions do not require new consent. Changes that are not "material" include (1) increases in death benefit due to the operation of § 7702 or the terms of the contract "provided the insurer's consent to the increase is not required"; (2) administrative changes; (3) changes from general account to separate account or vice versa; or (4) changes as a result of the exercise of an option or right granted under the contract as originally issued. Policies issued as a result of a 1035 exchange generally do not require new notice and consent if there is no material increase in the death benefit or other material change. In the absence of perfect clarity as to what constitutes "material change," it is good practice to comply with the notice and consent requirements when completing a 1035 exchange.

Notice 2009-48 is effective June 15, 2009. The IRS will not challenge good faith efforts to comply with the notice and consent requirements based on a reasonable interpretation of § 101(j) before that date.

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Non-qualified Deferred Compensation (NQDC)

Notice 2009-49, I.R.B. 2009-25 (June 22, 2009)

The Troubled Asset Relief Program (TARP) authorizes the U.S. Government to purchase stock in financial institutions, most of which are believed to have non-qualified deferred compensation (NQDC) plans subject to § 409A. One of the permissible payout events under § 409A is a change in control. Undoubtedly, some banker tried to get his NQDC paid out early, reasoning that the government's purchase of his company's stock triggered a change of control. In Notice 2009-49, the I.R.S. says "nice try," but the government's acquisition is not a change of control – even though it is …; therefore TARP purchases cannot trigger a change-of-control payout under a NQDC.

Stranger-owned Life Insurance

Wuliger v. Manufacturers Life Ins. Co., 2008 WL 397591 (May 28, 2009)

In this latest stranger-owned life insurance case, the Sixth Circuit Court of Appeals rules that a policy is voidable due to the insured's intent, at the time of issuance, to sell the policy. According to the Court, no agreement between the insured and a third party is necessary.

This publication is not intended as legal or tax advice; nonetheless, Treasury Regulations might require the following statements. This information was compiled by the Advanced Planning Division of The Northwestern Mutual Life Insurance Company. It is intended solely for the information and education and/or promotional purposes of Northwestern Mutual Financial Network Representatives and advisors with whom they work. It must not be used as a basis for legal or tax advice, and is not intended to be used and cannot be used to avoid any penalties that may be imposed on a taxpayer. Financial Representatives do not give legal or tax advice. Taxpayers should seek advice based on their particular circumstances from an independent tax advisor. Tax and other planning developments after the original date of publication may affect these discussions.

- To comply with Circular 230

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