The executor of the insured’s estate may use the money he receives from the FLP to help pay estate taxes and administration costs.

The FLP purchases a life insurance policy on the life of a general partner and is the owner and beneficiary of this policy. At the insured’s death, the FLP receives the proceeds generally income tax free, and either lends money to, or purchases assets from, the insured’s estate.

The executor of the insured’s estate may use the money he receives from the FLP to help pay estate taxes and administration costs.

Heirs receive the net assets of the estate, including partnership interests.

**What Is Being Accomplished?**

- Vehicle for purchasing life insurance for estate tax liquidity needs.
- Flexible alternative to an Irrevocable Life Insurance Trust for purposes of minimizing inclusion of policy in insured’s estate.
- Terms of partnership agreement may be amended by the partners.
- Insureds can control the partnership-owned policy through their general partner partnership interests without causing the entire proceeds payable to the partnership to be includible in their estates.
Life Insurance Family Limited Partnership

The Situation

In order to secure a source of liquidity to help pay estate taxes and other obligations, taxpayers often establish an Irrevocable Life Insurance Trust ("ILIT") to purchase and own a life insurance policy on the taxpayer's life. Upon the taxpayer's death, policy death benefits are paid to the ILIT with which the ILIT may either purchase assets from, or make loans to, the insured's estate.

The life insurance death benefit proceeds can remain out of the insured's estate only by eliminating his "incidents of ownership" over the policy. Accordingly, the insured typically will not be named as trustee, leaving him without control over the policy, or access to the cash value. Further, the ILIT must be made irrevocable so that the insured is not deemed to retain control over, and therefore incidents of ownership in, the policy.

This, of course, limits the taxpayer's flexibility in that, once established, the taxpayer may not revoke or amend the ILIT without a formal court order.

The Strategy

Many planners see the Family Limited Partnership ("FLP") as a more flexible alternative to the Irrevocable Life Insurance Trust. Among other benefits, the Family Limited Partnership offers these advantages over the ILIT:

- The terms of the partnership may be amended upon the agreement of the partners.
- Where the insured is the general partner, he has management control over partnership assets, including the policy on his life, for partnership purposes.
- Where policy proceeds are paid solely to the partnership, the insured should not have the entire policy proceeds included in his estate.
- The insured's gross estate will be increased by the life insurance proceeds only to the extent that they are attributable to, and increase proportionately, the value of his partnership interest.

How It Works

The senior generation members – typically parents or grandparents – make a nontaxable transfer of assets to the partnership in exchange for both general and limited partnership interests. Each parent retains a one percent general partnership interest and a 49 percent limited partnership interest.

The partnership may then purchase a life insurance policy on the life of one or on the lives of both of the general partners, naming the partnership as the sole beneficiary. The parents begin gifting limited partnership interests to their children and grandchildren, thereby reducing their interest in the partnership and its assets. The parents may, over time, and through utilization of their unified credits, gift away all of their limited partnership interests, effectively reducing their interest in the partnership. At death, policy proceeds are paid to the partnership, with which it may purchase assets from, or make loans to, the decedent's estate.

Advantages

- Unlike an ILIT, the FLP may be amended upon the agreement of the partners.
- If the insured is the general partner, he/she has management control over the partnership assets, including the life insurance policy on his/her life(s), for partnership purposes.
- If the death benefit proceeds are payable solely to the partnership, the insured should only have a proportional amount of the policy proceeds included in his/her estate equal to his/her ownership interest in the partnership.
- The FLP provides a flexible alternative to an ILIT for purposes of minimizing inclusion of a policy in the insured's estate.

Disadvantages

- Gifts of the limited partnership interests are not likely to qualify for the annual exclusion from gift tax. The senior generation must use their unified credits to gift their partnership interests to their children and grandchildren.
- The insured’s gross estate will be increased by the proportion of the life insurance proceeds attributable to his/her partnership interest.
- While most tax advisors would agree FLP can be used to transfer assets to family members at a discount, care must be taken to obtain a discount. In 2000, the IRS issued a Field Service Advice (FSA), advising its District Counsel on differing theories they could use to attack FLP discounts.3
- Establishing and administering a FLP is, however, a costly endeavor. The individual must employ valuation experts to value the underlying property, as well as to determine the appropriate discounts for lack of control and lack of marketability; attorneys to prepare the partnership agreement; and accountants to prepare annual tax returns. The cost of establishing and administering a FLP may outweigh the benefits of the FLP if an individual does not have a substantial amount of property to contribute to a FLP.

1 Proceeds from a life insurance policy paid because of the death of the insured are generally excludable from the beneficiary's gross income for federal income tax purposes. IRC Sec. 101(a)(1).
2 Pursuant to the Economic Growth and Tax Relief Reconciliation Act of 2001, federal estate taxes will be repealed for decedents dying between January 1, 2010 and December 31, 2010.
3 FSA 2000409203. The seven areas of attack include the economic substance doctrine, Section 2703, Section 2704(b), Section 2704(e), Section 2036, the gift on formation argument and challenges on the amount of the discount. See also FSA200143004.
Life Insurance Family Limited Partnership

Vital Information

Client’s Name(s): __________________________________________________________

Age/Date of Birth: _______________________________________________________

Sex: Male _____________ Female _____________ Unisex______________

Smoking Status: Smoker _____________ NonSmoker _________________

Death Benefit:

Base: _____________ Term: _____________

Death Benefit Option: Increasing _____________ Level ______________

Change Year/Age: __________________________________________________________________________

Premium Mode: Annual _______ Semi-Annual _______ Quarterly _______ Monthly_______

Lump Sum Pour In Amount: ________________

1035 Exchange: Yes_______________ No________________

Outstanding Loan: Yes_______________ Amount ________________ No_______________

Riders/Amounts:

Waiver of Charges/Duration (yrs): ______________________________________________

Accidental Death Benefit: _______________________________________________________

Guaranteed Insurability: _________________________________________________________

Disability Benefit/Duration (yrs): _______________________________________________

Spouse Rider/Age: __________________________________________________________________

Smoking Status: Smoker _____________ NonSmoker _________________

Child Rider/Age: __________________________________________________________________

/Age: _____________________________________________________________________________

/Age: _____________________________________________________________________________

/AGE: _____________________________________________________________________________

ADDITIONAL NOTES

Producer Name: ___________________________________________ Date: ______________________

Life Insurance Family Limited Partnership
Pacific Life Insurance Company
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