Lincoln *MoneyGuard*® Solutions

Advanced Sales Ownership Guide

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The topics examined in this document are not intended to be a full and complete discussions of all potential legal and tax issues. These Q&As are presented with the understanding that neither Lincoln Financial Group, nor its employees, are being engaged to render legal, accounting or tax advice. Interested parties should seek independent tax and legal advice before implementing any plan or strategy described in this document.

Insurance products issued by:
The Lincoln National Life Insurance Company

1. Owning a Lincoln *MoneyGuard*® Solution policy on other family members.

Q: Can an individual own a *MoneyGuard* policy on a parent, child or sibling?

A: Yes, Lincoln will accept these cases. The owner must have an insurable interest in the life of the insured. In other words, it is acceptable for an individual to own a *MoneyGuard* policy that insures a parent, child, brother or sister. From a tax perspective, a person is allowed to pay educational or medical expenses of any other person without it being considered a gift [see, IRC §2503(e)]. One of the requirements of the tax rules is that the policyowner will have to pay the long-term care provider directly, and then file a claim for reimbursement by Lincoln. As a practical matter, most nursing home payments are made automatically to the nursing home each month.

Here's how

Assume that a daughter is a successful business owner and she is concerned that her mother could not afford any substantial long-term care expenses. She recognizes that if her mother needed long-term care in a nursing home, she would have to pay much of the cost. She decides to buy a *MoneyGuard* policy insuring her mother but wants to be the owner and beneficiary of the death benefit. If her mother needs long-term care, *MoneyGuard* will provide whatever amount of long-term care (LTC) benefits she decided to purchase. If the mother never needs LTC, the daughter will receive the tax-free death benefit.

One additional tip is appropriate if a parent owns a *MoneyGuard* contract on one or more of their children. The parent should consider making the insured child the contingent owner of the policy. That way, if the parent dies first, the son or daughter will automatically become the owner of their own policy. This will also avoid ownership of the policy having to go through the probate process.

Lincoln will generally expand the list of allowable insured individuals to include a son-in-law or daughter-in-law of the policyowner. However, for more distant relationships we prefer that the individual gift the premiums to the relative and let them own the contract. Of course, a trust could also be acceptable as the owner of a *MoneyGuard* contract on a more distant relative. Lincoln's team of *MoneyGuard* underwriters have the final authority on which more distant relatives of the policyowner are acceptable.

2. Owning a Lincoln *MoneyGuard*® Solutions policy in a revocable family trust.

Q: Can a revocable family trust own a Lincoln *MoneyGuard* solutions policy on either spouse?

A: Yes. As long as the family trust (also known as a revocable or living trust) can be revoked by the grantor(s), the trust is not considered to be a separate taxable entity. For federal income and federal estate taxes, the policy is treated as if it were owned by either spouse.

Here's why

- Under the Internal Revenue Code (the "Code"), assets transferred to a revocable trust are considered to still be owned by the individual(s) who created the trust. A revocable trust can be established by one individual or by both spouses.
- Revocable trusts are so-called grantor trusts under Code section 671, meaning all the income received by the trust may be included on the individual income tax returns of the grantor(s). If a policy is owned by a revocable family trust, the tax laws treat the contract as owned by the insured/grantor.
- For federal estate tax purposes, the grantor(s) owns all assets held by the trust, meaning that the value of the assets are included in the grantor's estate at death. If the trust owns a Lincoln *MoneyGuard* solutions policy at the time of the insured's death, the value of the death benefit will be included in the insured's estate.
- The name or title of a trust can be deceiving. Many estate planners recommend using revocable trusts to avoid having to probate an individual's will. It is very common for a revocable family trust to become irrevocable upon the death of the first spouse in order to implement the estate plan.
- At the death of the first spouse, the trust's assets may be separated into spousal and nonspousal portions to help minimize estate taxes when the second spouse dies. If a beneficiary of an irrevocable trust is the proposed insured, then the trust is likely to be able to own a Lincoln *MoneyGuard* solutions policy on the beneficiary. See **Q&A 4** for more details. And, see **Q&A 6** for some of the special issues presented by blended families.

3. Ownership by irrevocable trusts in general.

Q: Can an irrevocable trust own a Lincoln *MoneyGuard*® Solutions policy on the trust grantors?

A: When one or more individuals create an irrevocable trust, the trust grantor(s) specifically include language that they will not receive anything of value from the trust (other than transfers of assets to or from the trust at fair market value). This effectively prevents the trust from owning a Lincoln *MoneyGuard* solutions policy on the trust grantor(s) because the trustee can't pay the grantor's LTC expenses, and then seek reimbursement from Lincoln. A later question will address the issues involved when the trustee is looking for a work-around so that an existing life insurance policy with a large gain on surrender can be exchanged for a *MoneyGuard* contract on the trust grantor.

4. Ownership of a Lincoln *MoneyGuard*® Solutions policy by an irrevocable trust created for the benefit of the proposed insured by a grandparent, parent, child, sibling or other party.

Q: Can an irrevocable trust purchase a *MoneyGuard* policy with a trust beneficiary as the insured?

A: Generally, yes. A trust can be a very effective way for a parent, or other family member to provide *MoneyGuard* long-term care reimbursements for a beneficiary of a trust. If the trust is properly drafted, the trust beneficiary cannot surrender the *MoneyGuard* policy and eliminate the protection against long-term care that the trust grantors funded.

Here's why

- Most likely the only critical issue is whether the trust provisions allow distributions of trust principal and income to the beneficiary. *MoneyGuard* long-term care reimbursements start reducing policy cash values dollar for dollar, which are treated under state law as distributions of trust principal. When the cash values are exhausted, the long-term care reimbursements should fit the state trust law definition of trust income.
- Trusts that only allow income distributions to the proposed insured will not allow the trustee to buy *MoneyGuard* under state law. You also need to look at the trust to see if any principal or income distributions are permitted during the grantor's lifetime. It is very common for a trust to not permit any distributions to the children (insureds) during the trust grantor's lifetime. It is also common that a trust might not allow distributions to the children while the grantor's spouse is still alive.
- The prevalence of blended families allows either or both spouses to use a trust to protect a current spouse from exposure to long-term care expenses. For example, if the husband set up the trust to own a *MoneyGuard* policy for his wife, the ultimate beneficiaries of the trust could be his children from a prior marriage.

5. Special problems with trusts for surviving spouses and children.

Q: With blended families, a husband may set up a trust for his current wife to care for the current wife and his children from a prior marriage. In many cases, the current spouse may receive all the income produced by the trust each year. Some of these trusts may permit principal distributions to the spouse, but many will prohibit principal distributions to the spouse because the trust is supposed to go to his children. Is there a Lincoln *MoneyGuard*® Solutions sale in this situation?

A: Obviously, if the trust permits income and principal distributions to the spouse, the trustee presumably has the authority to use trust principal to purchase a *MoneyGuard* contract inside the trust. Remember, reimbursements of long-term care expenses by a *MoneyGuard* contract reduces cash values until they are exhausted. These are principal distributions under state trust law. After the *MoneyGuard* policy's cash value has been exhausted, further long-term care reimbursements should be income distributions under state trust law.

Here's why

If the trust does not permit the trustee to make principal distributions to the spouse, then any potential *MoneyGuard* sale may need to concentrate on the annual income being distributed to the spouse. Fortunately, with our extended premium payment options, it might be much easier for the spouse to purchase his or her own *MoneyGuard* contract using income coming out of the trust each year.

6. Work-around for 1035 exchanges inside an irrevocable trust.

Q: Can you do a 1035 exchange into a *MoneyGuard* policy inside an irrevocable trust?

A: Often a client believes that he or she no longer needs the life insurance policy that is currently owned in an irrevocable trust. The client has decided what they really want is long-term care protection. Their first thought is that the trust should simply do a 1035 exchange into a *MoneyGuard* policy with the trust grantor remaining the insured. Usually, there is a significant gain on surrender of the old contract that the client would like to avoid. As noted in question 3, the typical irrevocable life insurance trust cannot own a *MoneyGuard* policy insuring the trust grantor. The question then becomes what work-arounds might be available.

Here's how

If there is only a small amount of gain in the contract, the trustee could surrender the contract on the trust grantor, and then purchase a *MoneyGuard* contract on a trust beneficiary (perhaps even the spouse). The grantor would then purchase his or her own *MoneyGuard* contract outside of the trust.

Review the trust and see if the trustee has the authority to distribute trust assets (while the grantor is alive) to one or more trust beneficiaries. If you are lucky, the grantor's spouse may be a beneficiary of the trust and could become owner of the old contract. The spouse could then do the 1035 exchange into a *MoneyGuard* policy. The spouse could remain the owner indefinitely, or the spouse could gift the policy to the insured spouse. If the children are the only trust beneficiaries, this approach works as long as the client is comfortable with his or her children owning the *MoneyGuard* contract.

Review the trust and see what the termination provisions would permit. If the trustee can terminate the trust, then one of the approaches described in the preceding paragraph may be available. Seek out and rely on your own legal counsel.

7. Tax-free exchanges under IRC §1035.

Q: What kind of insurance contracts can be exchanged tax-free for *MoneyGuard*?

A: Tax-free exchanges of life insurance, annuities and traditional long-term care contracts are permitted by IRC §1035. The IRS rules create a hierarchy of what types of exchanges are permitted. A life insurance contract can be exchanged for (a) another life insurance contract, (b) an annuity contract, or (c) a traditional long-term care contract. An annuity contract can be exchanged for (a) another annuity contract, or (b) a traditional long-term care contract. A traditional long-term care contract can only be exchanged for another traditional long-term care contract. Since *MoneyGuard* is fundamentally a life insurance contract, only other life insurance contracts can be exchanged tax-free for a *MoneyGuard* policy. In other words, you cannot exchange a deferred annuity for a *MoneyGuard* policy. In that case, the client might want to exchange it for a Lincoln annuity with a long-term care rider.

8. Using business dollars to pay for Lincoln *MoneyGuard*® Solutions.

Q: Does an executive bonus plan work for all types of business organizations?

A: Yes. Whenever the key employee owns the *MoneyGuard* contract and the employer is paying the premiums, the payment of the premiums can be treated as a bonus to the employee. The employer might want to use a double bonus approach to help the employee pay their taxes on the entire bonus. The price for the deductibility of the premiums to a business is that the employee is taxable on the total premiums paid in the executive bonus arrangement each year.

Here's why

If the proposed insured is the owner of a pass-through business (S-corporation, limited liability company or partnership), the executive bonus approach may not be the preferred way to handle the premiums. If the premiums are treated as additional compensation, they will be subject to employment taxes (that is, Social Security and Medicare taxes). These owners may prefer to simply take the premiums as a distribution of previously taxed income earned by the business, thereby avoiding additional employment and income taxes.

9. Ownership of Lincoln *MoneyGuard*® Solutions by a pass-through entity.

Q: Should an S-corporation, LLC or partnership own a *MoneyGuard* policy insuring any of the owners?

A: No. The IRS fringe benefit rules will result in any accident and health benefits being fully taxable if provided to (a) a 2% or greater shareholder of an S-corporation, (b) a partner, (c) a member of an LLC, or (d) a sole proprietor. This is obviously an unacceptable outcome for the insured. The business owners would be far better off taking a distribution of business income (current or prior years) and buying a *MoneyGuard* policy individually. It is also worth noting that if the business owns the policy, no deduction is allowed for the premiums paid.

Q: Can an S-corporation, LLC or partnership own a *MoneyGuard* policy insuring any of the nonowners of the business?

A: Technically, yes. Because the fringe benefit rules apply only to the owners of a pass-through entity, the business could own a *MoneyGuard* policy on a key employee with no ownership interest in the business. But, the owners don't like this approach because the business cannot deduct any portion of the premiums paid, thereby raising their own personal taxes so that the key executive can receive a tax-free benefit of long-term care coverage. The owners will prefer an executive bonus approach in this situation. Any time a business is the owner and beneficiary of a life insurance contract, the arrangement should comply with the COLI rules of IRC §101(j). See the next question for more discussion of the COLI rules.

10. Should a C-corporation consider buying a Lincoln *MoneyGuard*® Solution as a fringe benefit for key employees?

Q: Can a C-corporation own a *MoneyGuard* policy and provide tax-free long-term care coverage to employees?

A: Yes. There are a couple of important factors to remember to make sure the long-term care coverage is tax-free to the employee. First, the insured should be a W-2 employee when they are first covered. The coverage can continue into retirement, but they should be an employee when the *MoneyGuard* policy is purchased by the employer. In addition, like other group medical insurance plans, the C-corporation could purchase a *MoneyGuard* policy on the life of a spouse of an employee.

Q: If a C-corporation is the owner and death benefit beneficiary of a *MoneyGuard* contract, do the notice and consent rules of IRC §101(j) apply?

A: Yes. In fact, the rules of IRC §101(j) apply to any business (C-corporation, S-corporation, LLC, partnership or sole proprietor) that owns life insurance on an employee. Prior to issue of the contract, the insured should be given notice that the employer is purchasing life insurance on the employee's life. The employee has to give written consent to the employer owning life insurance on his or her life. If the employer fails to comply with the notice and consent rules, amount of the death benefit in excess of the premiums paid will be ordinary income to the employer. It should be noted that IRC §101(j) only applies to insurance on employees. If the employer will own *MoneyGuard* on a spouse of the employee, you may have no way to make the full amount of the death benefit tax-free to the employer. Therefore, we always recommend that the employer consider allowing the employee to designate a family member as the beneficiary of the death benefit.

Here's why

The premiums paid by the employer are not deductible when the C-corporation owns the *MoneyGuard* contract. However, if an employee (or former employee) ever needs long-term care, the corporation can deduct the actual long-term care benefits when they are provided. It does not matter that they are being reimbursed by the *MoneyGuard* contract. Admittedly, it may be years, even decades before the employer is able to deduct any long-term care benefits provided. Remember, the primary goal of this approach is to provide tax-free long-term care coverage, and long-term care benefits to a key employee for the rest of their lives.

11. Exit strategies for business-owned Lincoln *MoneyGuard*® Solutions contracts.

Q: Whenever a business owns a *MoneyGuard* policy, what happens if the employer wants to change ownership to the employee (or former employee) at some point in the future?

A: The change of ownership may have income tax consequences to the business and to the employee. One approach is to bonus the policy to the employee as additional compensation. As described in question 7, the bonus should be deductible to the business, and taxable to the employee. The employer has the option of using a double bonus approach to help the employee pay his or her income taxes on the entire bonus amount.

Here's why

Unless the employer has selected the 100% return of premium feature, a corporation is unlikely to produce any taxable income to the employer when ownership is changed to the employee/insured. Remember, the employer's cost basis in the contract is reduced by each year's long-term care charges. If the employer selected the 70% return of premium feature, except when the long-term care charges are larger because of the age of the client or the inflation option chosen, the adjusted cost basis may never go below the 70% return of premium amount. However, this is a case-by-case analysis that can be determined by looking at the illustration.

There may be situations, such as when the insured is the 100% owner of a C-corporation, when a dividend may be a more tax-efficient way to change ownership of the policy. The corporation gets no tax deduction when the *MoneyGuard* contract is transferred to a shareholder, but the shareholder is taxed at capital gains rates instead of the ordinary income tax rates that apply to a bonus.

In this regard, the employer needs to be aware that if they promise to transfer the policy at some point in the future (for example, after 10 years), they have created a deferred compensation plan that must comply with all of the complex rules IRC §409A. The complex rules of Section 409A are beyond the scope of this Q & A. Suffice it to say that the time of the ownership change has to be fixed at the outset of the arrangement. Any acceleration of the time of transfer can result in the imposition of a 20% excise tax. Any delay in the time of the transfer has to be made at least one year before the transfer was originally scheduled to take place, and the new date has to be at least five years after the originally scheduled date. Most financial professionals will want their clients to avoid making promises about future ownership changes to the employee/insured.

12. Beneficiary considerations on business-owned Lincoln *MoneyGuard*® Solution.

Q: If the business owns the *MoneyGuard* contract, what are the options regarding who should be beneficiary of the death benefit?

A: In many cases the employer wants to keep the death benefit as a form of cost recovery. As to the death benefit, this would essentially make the arrangement a corporate-owned life insurance (COLI) contract. At the other extreme, the employer may allow the employee to name the beneficiary. If the employee names the beneficiary, the parties need to decide if the death benefit should be taxable, or nontaxable to the beneficiaries. Although it may seem counterintuitive, we generally recommend a taxable death benefit. If the employer chooses a taxable death benefit, the employer's only tax reporting obligation is to report the death benefit paid to the employee's beneficiary.

Here's why

To make the death benefit tax-free, the parties must comply with the economic benefit split-dollar rules. This requires the employer to report the value of the death benefit protection as additional income each year. The amount of the income each year can be calculated using IRS Table 2001. This requires the employer to actively administer the policies each year. It may be 10, 20, 30 or more years before the insured needs long-term care.

Therefore, the employee may report a significant amount of income over the years, only to have the named beneficiaries receive the residual death benefit.

A taxable death benefit is simpler and avoids requiring employees to report the value of the death benefit protection every year.

13. Lincoln *MoneyGuard*® as a corporate-owned life insurance (COLI) contract.

Q: If the employer owns the *MoneyGuard* contract, does IRC §101(j) apply to the contract?

A: Yes. Any time the employer owns a *MoneyGuard* contract on an employee, the employer is required to comply with the rules of IRC §101(j). At issue, the employee must receive notice that the employer is (a) going to be the owner of the policy, (b) the amount of the initial coverage, and (c) the employer has the right to retain the coverage after the employee has terminated employment. In addition, the employer must include IRS form 8925 with their income tax return each year to report the number and coverage of all COLI contracts owned by the employer.

Q: How does the accounting for *MoneyGuard* work with a COLI contract?

A: Under generally accepted accounting principles (GAAP), the employer shows the *MoneyGuard* policy's cash value (including the return of premium) as an asset on the employer's balance sheet. Since the employer has promised the long-term care coverage to the employee for life, the GAAP rules will require the employer to accrue a liability for the cost of the future long-term care benefits over the expected remaining working career of the insured/employee. Most accountants appear to be comfortable with the maximum liability accruing to the total premiums paid for the contract. Most accountants appear comfortable using age 65 as a reasonable assumption over how long the insured/employee will continue to remain employed. Remember, Lincoln does not allow us to provide legal, tax or accounting advice to our customers.

14. Lincoln *MoneyGuard*® Solutions and premium financing.

Q: Are there any problems if the client uses premium financing to purchase a *MoneyGuard* contract?

A: Yes. If the loan is outstanding, the premium financing lender will have a collateral assignment of the *MoneyGuard* contract. Therefore, if the insured needs long-term care, the assignment will require Lincoln to make the reimbursement payments to the lender, and not the insured. This essentially will force the insured to pay his or her own long-term care expenses. Obviously, this is not generally why the individual purchased the *MoneyGuard* contract in the first place.

Here's why

Unlike some of the premium financing plans we use with our Indexed UL contracts, the *MoneyGuard* contract is not designed for policy loans or withdrawals that could be used to repay the premium financing. This would suggest that the only viable exit strategy for the premium financing loan is for the insured/owner to repay the loan with other cash or investments. It is also worth noting that in the current premium financing market, most of the loans are over $1 million in size. By contract, the total premium on most *MoneyGuard* contracts is usually well under $500,000.

15. Lincoln *MoneyGuard*® Solutions in a qualified retirement plan.

Q: Can a *MoneyGuard* policy be owned in a qualified retirement plan?

A: No. Lincoln does not permit the sale of *MoneyGuard* contracts to any qualified retirement plans. First, IRC §§ 408 and 408A specifically prohibit life insurance in IRAs and Roth IRAs. Although profit sharing plans and IRC § 401(k) plans can own life insurance in a participant's account, we are concerned that any long-term care benefits received by the participant will be fully taxable income. There is no IRS guidance on a qualified plan owning a hybrid life insurance and long-term care contract. With traditional universal life policies in a qualified plan, the participant's beneficiary is only entitled to the excess of the death benefit over the policy's cash value. If the cash value is paid out to the participant's beneficiary, the cash value is a taxable pension plan distribution. Remember, a *MoneyGuard* policy's long-term care reimbursements reduce the policy's cash value dollar for dollar. It is the payout of that cash value that should be taxable. Since our customers expect tax-free long-term care reimbursements from a *MoneyGuard* contract, we did not want *MoneyGuard* contracts owned by a qualified retirement plan.

16. Lincoln *MoneyGuard*® and deductible for medical expenses.

Q: Why is no portion of the premiums paid for a *MoneyGuard* policy deductible as a medical expense?

A: Some of Lincoln's competitors believe that their versions of *MoneyGuard* are somehow different, and that the long-term care rider charges are deductible as an itemized medical expense, or that if a business owns the policy the long-term care rider charges are potentially deductible as a business expense for fringe benefits provided to the employee/insured. They appear to believe that if they separate the LTC rider charges from each premium payment when the money first arrives at the insurer, that their customers can avoid the clear intent of IRC §7702B(e)(1) and (2).

Here's why

Prior to the Pension Protection Act of 2006 (the "PPA"), our competitors were correct that the LTC rider premiums were a deductible medical expense. It was the clear intent of Congress to change this tax treatment, and IRC §7702B(e)(2) specifically states that no portion of the premium for the LTC rider charges is a deductible medical expense. Our competitors point to the phrase "… if such payment is made as a charge against the cash surrender value of a life insurance contract …" as justification for their position. By intercepting the LTC rider charges before they become part of the cash value of the life insurance, they think that makes the LTC rider charges deductible as a medical expense.

The IRS has long asserted that the substance of a transaction is more important than the form of the transactions. In this case, the LTC rider cannot be purchased separately from the underlying life insurance contract. If the underlying contract lapses, the LTC rider also lapses. It is worth noting that IRC §7702B(e)(1) states that the LTC rider on a hybrid life/LTC contract is treated as if it was a separate contract.

There is no indication that any of Lincoln's competitors approached the IRS to request a private letter ruling that their analysis is correct. Lincoln obtained a private letter ruling before introducing our *i4Life*® annuity precisely because we wanted to protect our policyholders from potentially adverse IRS action.

For more information, contact your Lincoln representative.

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Policies:

***MoneyGuard Market Advantage*® is a variable universal life insurance policy issued on policy forms ICC20-MGV892/20-MGV892 with a Long-Term Care Benefits Rider (LTCBR) on Rider Form ICC20LTCBR-892/LTCBR-892, a Value Protection Rider on Form ICC20VPR-892/VPR-892 and a Benefit Transfer Rider on Form ICC22BTR-895/BTR-895.**

***MoneyGuard Fixed Advantage*® is a universal life insurance policy with a long-term care benefits rider issued by The Lincoln National Life Insurance Company, Fort Wayne, IN, on Policy Form ICC19-MG890/19-MG890 with the following riders: Value Protection Endorsement (VPE) on form ICC19END-10534/END-10534; Terminal Illness Acceleration of Death Benefit Rider (TIR) on form ICC19TIR-891/TIR-891; Long-Term Care Benefits Rider (LTCBR) on form ICC19LTCBR-890/LTCBR-890; Benefit Transfer Rider on form ICC21BTR-894/BTR-894. Available in all states except CA and NY.**

Lincoln *MoneyGuard*® II, universal life insurance policy form LN880/ICC13LN880 with the Value Protection Rider (VPR) on form LR880 and state variations/ICC15LR880 Rev, Long-Term Care Acceleration of Benefits Rider (LABR) on form LR881/ICC13LR881, and optional Long-Term Care Extension of Benefits Rider (LEBR) on form LR882/ICC13LR882. Only available in CA.

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