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LAGOS
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BUILDING, PROTECTING AND PERPETUATING FAMILY WEALTH

The PASS PLUS Tax Strategy
Tax Free Income & Tax Free Gifting

Partnership Administration Succession Strategy ("PASS") is a tax strategy utilizing a separate partnership.

The **PASS PLUS strategy** involves the formation of a partnership among the individual owners of the business, *including* the business entity itself. Each of the owners would acquire a life insurance policy on his/her own life, and subsequently transfer the policy to the partnership as his/her capital contribution. Thereafter, the business entity would periodically contribute cash to the partnership as its capital contribution, and the partnership would use the cash to pay the premiums on the life insurance policies.

As an alternative design the business owners may employ this strategy for funding their Buy/Sell agreement and enter into a cross-purchase agreement that obligates them to purchase each other's interests in both the primary business and partnership following specified trigger events.

Perhaps the most significant benefits of the PASS PLUS tax strategy relate to the tax and financial advantages it offers in shifting business dollars for Tax Free Income as well as Tax Free Gifting for estate tax planning.

In the PASS Plus tax strategy cash is received by the partnership directly from the business entity as partnership capital. ***As a result, it is not considered taxable income to either the owners or the partnership.*** This strategy provides the benefits of an equity split dollar arrangement without the income tax consequences resulting from "economic benefits" or "below market interest".

To further enhance the shifting of business dollars a traditional premium financing strategy is employed and the business entity obtains a loan secured primarily by the collateral of the life insurance policy cash values. The loan is structured over several years to avoid a "MEC" and each loan is a business entity contribution to the partnership. Under this arrangement the business entity does not have taxable income or undistributed income as a result of the premiums contributed, but rather interest expense.

A business may generally deduct interest expense under IRC163. The deduction is limited and under IRC264(a)(2) a business entity may not deduct interest on indebtedness which is incurred to carry a single premium life insurance policy, and under IRC264(a)(4)&(e) assuming it is not a single premium policy but insures a key person, the deduction is limited to the first $50,000 of indebtedness. These limitations are not exclusive and both are presumed to apply to policies owned by the business. It may therefore be reasoned that the interest on the indebtedness in this transaction may be deductible to the business entity. Should the transactions be traced as related, it may be collapsed without benefit of the deduction.

In the plan design the loan is withdrawn as basis from the owner's policy cash values to the business entity partner and the partnership is dissolved and the capital accounts distributed. This transaction provides the business entity with settlement of the loan, and the owners receive as distribution their policy cash values income tax free. The cash values may be taken as ***a lump sum or as periodic payments entirely income tax free***.

The **PASS PLUS strategy** ***can be structured to provide estate tax planning opportunities for the owner***. The formation of the partnership is between the business entity and an irrevocable trust created by the owner. ***This design eliminates individual income and gift tax consequences to the insured owner for the policy premiums.***

The partnership design may include the owner as a partner along with the trust/partner providing further flexibility**.** This structure may require the owner to fund the economic benefit to the Trust partner, gift a partnership interest to the trust, or provide restrictive provisions in the partnership agreement to avoid incidents of ownership for the estate tax exclusion.

When the owner dies, the partnership is terminated the business entity receives a portion of the death proceeds equal to its capital account (cash contributions for policy premiums) and the balance of the death proceeds are paid to the irrevocable trust/partner.

At partnership termination prior to death, the owner receives the policy as a capital account distribution. The owner can then contribute the policy as a capital contribution to a newly formed partnership, or receive tax free income distributions from the policy cash values.

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