BEST MONTHLY WEBINAR

ADVANCED PLANNING
LIFE INSURANCE STRATEGIES

Presented by:
Edward J. Barrett

CFP®, ChFC®, CLU, CEBS®, RPA, CRPS®, CRPC®, CPFA
Founder, President & CEO
1-800-345-5669 www.brokered.net
customerservice@brokered.net

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Agenda

- What we will cover today…
  - Role of Life Insurance
  - Your Role As the Financial Advisor
  - Myth BTID
  - Advanced Life Insurance Planning Strategies

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Role of Life Insurance

- It provides a valuable social purpose:
  - Family Protection: To replace income of one or both spouses in the event of premature death;
  - Tax-deferred wealth accumulation vehicle to provide tax-free supplemental retirement income;
  - To provide estate liquidity; and
  - To fund employee benefit and succession planning in a business.

A multi-purpose product

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Facts About Life 2017*

- The life insurance industry pays out $1.5 billion every day through payments from life insurance, annuities, LTCI, DI insurance and other types of insurance products. [1]
- The number of adults and children who own life insurance has grown to 172 million. The individual life ownership rate is 44%. Mean total coverage amount is $200,000.[2]
  - Of the people who own a life insurance policy, 1 in 5 admit they don't carry quite enough.[3]
- LIMRA estimates that 48% of households (60 million) have a life insurance coverage gap of $200,000 on average, which amounts to more than $12 trillion in total market need, and grows by $340 billion per year.[4]

Source:[1] LIMRA Facts About Life 2017; https://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/LIAM/PDF/Facts-of-Life_2017(1).pdf [2,3,4] Life Insurance Marketing Research Association (LIMRA), Facts on Life Insurance 2017, released November 2018

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Facts About Life 2017 (cont'd)

- Overall, 7 in 10 households said they would have trouble covering everyday living expenses after several months if the primary wage earner died.[1]
  - In 2010, those insured had coverage to replace their income for 3.5 years. Today that has dropped to 3 years, which is far lower than most industry recommendations.[2]
- Adults admit to not buying a policy because they find it too costly, and not a priority among other financial obligations. However, they tend to overestimate the cost, especially the Millennials.[3]
- About 50% of people would prefer to do business with a financial professional in some way, with more than a third already doing so, and about 1 in 10 in the process of finding the right fit.[4]

Source: Source:[1] LIMRA Facts About Life 2017; https://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/LIAM/PDF/Facts-of-Life_2017(1).pdf [2,3] Life Insurance Marketing Research Association (LIMRA), Facts on Life Insurance 2017, released November 2018; [4] https://www.bestliferates.org/blog/2018-life-insurance-statistics-and-facts/

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Mortality Experience in 2015*

- Deaths in America
  - Deaths in 2016 = 2,744,248
- Leading causes:
  - Heart Disease (635,260)
  - Cancer (598,038)
  - Accidents (unintentional injuries) (161,374)
  - Chronic lower respiratory diseases (154,596)
- Life Expectancy for the total population (78.6 years) decreased for the second year in a row(Opioid crisis).

Your Chance of death is 100%.
Are your prepared?

Source: *National Center for Health Statistics, Centers for Disease Control and Prevention, https://www.cdc.gov/nchs/fastats/deaths.htm National Vital Statistics report; https://www.cdc.gov/nchs/data/nvsr/nvsr66/nvsr66_06.pdf

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Benjamin Franklin

"It's a strange anomaly that men should be careful to insure their houses, their ships, and their merchandize, and yet neglect to insure their lives; surely the most important of all to their families and more subject to loss."

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Your Role as the Financial Advisor

- Goals-Based Wealth Management
  - Determine the need and the amount of life insurance based on client's objectives;
  - Determine the costs to meet the needs; and
  - Determine the proper type of life insurance policy.

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Determine the Need for Life Insurance

- Three Approaches:
  - Rules of thumb (least reliable)
  - Human Life Value
- Comprehensive Needs Analysis

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Rules of Thumb

- Use of Annual Gross Income (AGI):
  - 17 x salary ($75,000 x 17 = $1,275,000)
  - 6 to 8 x AGI
  - 5 x AGI plus mortgages, debts, final expenses and any other funding need.
- Premium as a % of AGI:
  - 6 % of breadwinner's AGI plus an additional 1% for each dependent

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Human Life Value

- Based on present and future income that would be lost if the insured dies (applied in wrongful death litigation).
- Components:
  - Project working years;
  - Project rate of earnings growth;
  - Subtract "self-maintenance" items (taxes, insurance premiums); and
  - Subtract existing savings, investments and life insurance

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Human Life Value Example

John, is 37, married has two children, and is an associate in a law firm. His annual compensation is $100,000 and his income tax rate is 30%. Assume John will retire age 65, inflation will average 3% per annum, and that invested assets will earn 5% after tax.

John's after tax annual income is $70,000 [$100,000 x (1 – 0.30). The inflation adjusted discount rate is calculated as:

$$\frac{(1 + 0.05)}{(1 + 0.03)} - 1 = \frac{(1.05)}{(1.03)} - 1 = 0.0194$$

Therefore the inflation adjusted discount rate of 1.94% . The PV of $70,000 (John's after-tax income) for 28 (age 37 to age 65) years at a discount rate of 1.94% is **$1,530,460**. This calculation assumes payment is made at the beginning of the period. Note that a financial calculator was used to compute this number.

Planning Tip: If family wants to use life insurance to replace the full earning power of the income earner for 20 to 25 years, assuming 5% net return on investments and a 3% rate of inflation then the amount of insurance required is about **20 X the annual after-tax income** of the income earner. The 20 x rule will vary with age. A younger client in his/her 20s/30s may have a higher multiple of 25-35. An older client in his/her 50s may have a lower multiple of 10-15.

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Comprehensive Needs Analysis

- Estimates the insured's family needs directly
- Two categories
  - Lump-sum cash needs
  - Multi-period income

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Lump-Sum Cash Needs

- Emergency fund - continue family living expenses (minimum 6-12 months)
- Administration Expenses / Funeral and Medical Costs
- Indebtedness
- Specific Cash bequests to Heirs
- Education Funds
- Taxes: Income taxes; Estate, Inheritance, and GST Taxes
- Expenses and Taxes related to Family Business

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Multi-Period Income

- An adjustment period income;
- The surviving spouse's income needs;
- The children's income needs; and
- The spouse's retirement needs.

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Evaluating Life Insurance Products

- Match the Product to the Problem
  - Four Factors:
    - The client's personal preferences, prejudices, and priorities;
    - The amount of insurance needed;
    - The client's ability and willingness to pay a given level of premium (cash flow considerations); and
    - Holding period probabilities (duration of need considerations)

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Determine the Type of Life Insurance

- Rules of Thumb:
  - Buy term insurance if the need will probably last for 10 years or less.
  - Buy term if the client has a high-risk propensity
  - Buy term if the client has a "lease rather than own" preference
  - Buy some type of CV accumulation insurance if the client wants something to show for his/her money at any given point.
    - The more important it is for the client to have CVs and/or dividends at any given point, the more insurance coverage is indicated
  - Buy a mix of term and CV value accumulation if the client is—like most clients—not so solidly on one end of the spectrum or the other.

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The Proper Type of Insurance Policy

- Most people have the wrong type of insurance[1]:
  - More insured adults depend solely on group life insurance for their only life insurance coverage.
    - The percentage of adults having group life insurance has surpassed adults owning individual life insurance (36% to 35%)
  - About 4 in 10 insured spouses have only Group Life Insurance coverage.
  - People insured only through Group Life Insurance have the lowest average amount of coverage (underinsured).

Source: Life Insurance Marketing Research Association (LIMRA), Facts on Life Insurance 2015, released September 2015; http://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/_Media/PDFs/2015-LIAM-Fact-Sheet.pdf; ACLI Facts About the U.S. Life Insurance Industry

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Myth: Buy Term and Invest the Difference*

- For decades the rally cry of many Advisors has been for clients to buy inexpensive term rather than more expensive permanent life insurance
  - The problem is most clients never execute the second part of the equation, leaving many of them uninsured in later life and unprepared for retirement.
- Traditional BTID models, ignore the valuable options of permanent life insurance such as the flexibility to borrow against the cash value or to take tax-free-distributions.

Source: Professor David Babbel, Wharton School of Business; co-author of "Buy Term and Invest the Difference Revisited," published in the Journal of Financial Services Professionals; May 2015 .

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"Our study sheds light on Wall Street guidance that has been taken as an article of faith, but that clearly under-performs for many who follow it. Without question, the American people deserve better than BTID. With a national retirement savings deficit of about $4.13 trillion for all U.S. households,* Americans need sound and realistic financial guidance that they can rely on, which this study aims to provide."

~ David Babbel

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Permanent CVLI as a tax-free supplemental retirement savings vehicle.

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Permanent Life Insurance

- Permanent life insurance consists of an insurance protection component (term insurance) plus a savings component (CV).
  - Savings component provides strong tax advantages under the Internal Revenue Code (IRC).
- So the question:
  - Should a client who needs insurance "buy term and invest the difference"? Or
  - Should a client use the CV as a tax-deferred savings vehicle for tax-free supplemental retirement income?

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Tax Benefits of Permanent Life Insurance

- Income Taxation of Death Benefits
  - IRC § 101(a) life insurance death benefit is entirely income tax free
- Income Taxation of Benefits Received During Life
  - IRC § 7702(g): Any growth/gains on the cash value within a life insurance policy are not taxable each year, as long as the policy is not a Modified Endowment Contract (MEC).
    - IRC 7702A: A MEC is an overfunded life insurance policy in which premium payments exceed the 7-pay test. The 7-pay test measures the premium required to fully fund the policy in a 7 year period.
  - IRC § 72(e)(5): If the policy is fully surrendered – which means by definition all principal and all gains were withdrawn (at once) – any gains are fully taxable as ordinary income.

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Tax Benefits Received During Life

- Policy Loan: IRC § 72(e)(5)(A)(i):
  - Policy loans from a life insurance contract (not a MEC) are not treated as distributions (tax-free).
- Policy Withdrawals/Distributions: IRC § 72(e)(5)(C):
  - Distributions are treated first as a return of principal (investment in the contract), and gains are only taxable after all costs basis has been recovered (FIFO)." (MEC are taxed gains first--LIFO).
- Cost Basis: IRC § 72(e)(6):
  - Cost basis is equal to the total premiums paid for the policy, reduced by any prior distributions/dividends.
- Tax-free Dividends: IRC § 72(e)(4)(B)
  - Dividends are not included in gross income (return of premium).

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Policy Loan Treatment

- Policy owner can borrow against the policy without incurring any tax consequences
  - Technically a life insurance policy loan is really nothing more than a personal loan from the life insurance company, for which the CV of the policy is collateral for the loan (at favorable rates)
- Repay the loan prior to death (tax free)
- Repay the loan at death (reduction of DB)

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Tax–Efficient Draw Down Strategy in Retirement

TAXABLE
- ✓ Cash
- ✓ Checking
- ✓ CDs
- ✓ Money Market
- ✓ Non-Qualified Investment Accounts

What you put in has already been taxed.

Interest & Dividends you take out are taxable.

Theses assets are funded with after-tax dollars and every year the owner receives a 1099 form for any interest or dividends earned. This category is often beneficial for high liquidity.

TAX-DEFERRED
- ✓ 401(k)/403(b)
- ✓ Traditional IRAs
- ✓ SEP/SIMPLE Plans
- ✓ Pension
- ✓ Qualified Retirement Plans

What you put in is before tax.

What you take out is taxable.

Theses assets provide tax-deductible contributions and tax-deferred growth, but are taxed as ordinary income upon distribution. Often the only category used by many Americans for retirement.

TAX-FREE
- ✓ Roth IRA
- ✓ Roth 401(k)
- ✓ Municipal Bonds
- ✓ Cash Value Life Insurance

What you put in has already been taxed.

What you take out is tax-free.

These assets are funded with after-tax dollars, may have the option for tax-deferred growth and may be distributed income tax-free.

A New Look on Life

Cash value Life Insurance offers the advantage of a tax-free death benefit and the potential for income-tax free withdrawals and policy loan provided the policy is properly structured and remains in force.

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Ed Slott

"Life insurance is the greatest and most underutilized loophole in the tax code."

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Advanced Planning Strategy

Spousal Lifetime Access Trust (SLAT)

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Do You Have Clients with …

- The following concerns:
  - Need for DB protection
  - Tax planning strategies
  - Asset Protection
  - Education Funding
  - Supplemental tax-free retirement income
  - Create a legacy but hesitant to let go of control should their financial circumstances change in the future.

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The Solution: SLAT

- The Spousal Lifetime Access Trust: A lifetime irrevocable trust created for the benefit of the donor's spouse (and/or children). Can have dual SLATs.
  - Functions like a bypass (B) trust but funded during life as opposed to a bypass trust that is funded by bequest when someone passes away
- As with a bypass trust the SLAT can provide access to:
  - Just a spouse or a spouse and children,
  - May automatically distribute income or make income distributions discretionary, and
  - May prevent any distributions of principal or also allow principal distributions for H, E, M and W, depending on the trustee

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SLAT Benefits

- The ability for the grantor's spouse to receive distributions from the trust (during grantor's lifetime/after grantor's death):
  - Grantor may indirectly benefit from the distributions.
- Other benefits:
  - Assets in the trust grow income tax free (grantor trust)
  - Trust beneficiaries receipt of DB free of income and estate taxes
  - Preserving the GST exemption ($11.2 million)
  - Protection of assets from grantor's and beneficiaries' creditors
  - Probate avoidance and management of assets subject to terms of the trust.
- Maximizes leverage in "decoupled" states.

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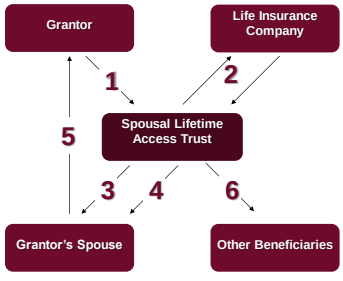
How the Spousal Lifetime Access Trust Strategy Works

1. Grantor creates the Spousal Lifetime Access Trust and makes gifts to the trust; the grantor's spouse is one of the trust's beneficiaries.
2. Trustee uses the gifts to purchase a cash value life insurance policy on the grantor and pay the policy premiums; death benefits are paid to the trust when the grantor dies.
3. Each year the trust allows the Spouse to elect to receive all trust income and/or to demand the trustee distribute the greater of $5,000 or 5% of the trust's assets.
4. Each year the trustee has the discretion to distribute additional assets for the spouse's health, education, maintenance and support.
5. Spouse may elect to gift or share any distributions from the trust with the grantor.
6. After the spouse's death, the trustee may make distributions to the other beneficiaries according to the trust's directions.



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Reciprocal Trust Doctrine

- Avoiding the Reciprocal Trust Doctrine
  - Which states that if Person A creates a trust for B, and Person B creates an identical (i.e., reciprocal) trust for A, that the courts can "uncross" the trusts and treat the situation as though each person created a trust for his or her own benefit.
  - When there is a need to create two SLATS, the following techniques may keep them separate. They are:
    - Naming different trustees and naming different beneficiaries
    - Providing the trust different powers-of-attorney
    - Space out trusts to be established in different years and with different assets

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Grantor's Spouse Pre-deceases Grantor

- SLAT will provide upon the death of the grantor's spouse the trust will divide into separate generation-skipping trusts (GSTs) for the benefit of the grantor's descendants.
- Or, can provide access back to the grantor by giving the grantor's spouse "a limited power of appointment" to appoint assets of the SLAT to a separate trust for the benefit of the grantor upon death of grantor's spouse (no inclusion in either estate and still maintain asset creditor protection).

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Divorce of Spouse

- Divorce may terminate the spouse's status and may end his/her ability to receive trust distributions.
- Remarried. If the grantor spouse remarries, the new spouse may take over as beneficiary of the trust.

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Advanced Planning Strategy
Split Dollar Life Insurance

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Put Me in Coach! Split Dollar Life

Jim Harbaugh is the highest paid college football coach in the country.[1]

- A life Insurance policy purchased on the life of Coach Harbaugh with a $35.6 million DB and annual premiums of $4 million in 2016 and then $2 million for next 5 years.
  - Michigan will only have to report approximately $68,250 as annual compensation (economic benefit of $2m premium).
  - "…it provides Harbaugh with millions of dollars of tax-free supplement retirement income"[2]
- A creative deferred compensation alternative using Split Dollar Life Insurance (Loan Agreement).

Source: [1,2] National Underwriter; http://www.lifehealthpro.com/2016/11/16/cash-value-life-insurance-makes-harbaugh-college-f All of the legal documents and loan agreements must comply with banking, insurance and tax regulations.

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"We're using life insurance as a vehicle to deliver value. The great thing is the value. The way the design of this works, he gets value that he gives back when his estate settles years from now. The university is essentially loaning him the money during his lifetime, but it comes back to us. I'm really proud of this idea. It's generous of him. It's a great deal."

Jim Hackett –
Former Michigan Interim Athletic Director

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Split-Dollar Life Insurance

- A strategy in which a life insurance policy's premium, CVs and DBs are split between two parties (ER/EE).
  - A method of financing the purchase of life insurance.
- Two Methods:
  - Endorsement Method
  - Loan Regime Method (IRC § 7872).

IRS Notice 2007-34 provides that split dollar is not subject to the deferred compensation rules of IRC § 409A. See § 1.409A-1(a)(5).

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Endorsement Method Split Dollar

- An agreement between ER and the EE in which the ER is the applicant, owner and beneficiary of the life insurance policy on the EE.
- The ER pays all or most the policy's premium. The ER has an interest in the policy's CV and DB equal to the greater of the policy's premiums or CV.
- The excess DB (the DB in excess of the CV) to the employee who is authorized to select a beneficiary for this portion of the DB.
- Employee is taxed on the economic benefit portion of the premium using the lower of Table 2001 term costs or the insurers ART costs.

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Loan Regime Split Dollar

- The employer pays the policy's premium, and the premium payment is treated as a loan (a non-recourse loan) to the EE.
  - EE must pay back both the interest and the principal. The interest rate is based on the AFR.
- The employee (or ILIT) owns the policy and collaterally assigns the CV (not to exceed the outstanding loan balance) of the policy to the business.
  - The EE (or ILIT) retains the CVs over and above the outstanding loan balance (i.e., equity) which can be used as tax-free supplemental retirement income.
- The employee will pay income tax on the "imputed loan interest" calculated using the AFR rates.

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Michigan Split Dollar Arrangement

- UM paid $4 million in 2016, and will pay $2 million for next 5 years total of $14 million to fund $35 million DB.
  - The loan does not have to be paid until Harbaugh dies. UM will be repaid $14 million and Harbaugh Trust will receive the remainder of the DB (150 percent of amount due back UM est. $21 million)
  - Age 70. "Loan agreement" only requires that the residual DB (net of loan) be at least $1,120,000.
  - Estimated that he could begin taking $1.4 million per year out of the policy, tax-free; beginning at age 66 and continuing all the way through age 98.
  - At the same time, his heirs would receive a residual DB (net amount owed back to UM) that reaches as a high as $35.3 million—if he dies after all payments have been made DB will drop to $1.4 million at age 98 (after having pulled $46.2 million out of the policy tax-free.)

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Death Benefit Only (DBO) Plan

- Funds can be paid to the Coach's family pursuant to a DBO option
  - The University may combine or add an additional benefit plan to allocate the DB that it receives as part of its cost recovery under the SD arrangement to the coaches family or other named beneficiaries.
  - Payments are taxable income but can be structured so that the payments are estate tax-free.
  - If the payments are made to a designated beneficiary that does not provide the employee with the ability to change or revoke the beneficiary designation, the payments can avoid estate taxation.

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The Excise Tax: IRC § 4960

- The Tax Cuts Jobs Act of 2017 now imposes a new excise tax at the rate of 21%, on tax-exempt organizations (TE), to the extent that annual compensation paid to any of its five highest compensated employees exceeds $1,000,000.
- TE organizations will now have to be creative to avoid the application of IRC § 4960 including the use of Split Dollar arrangements and coordinate Third-Parties to supplement compensation.[1]
  - Disclosure requirements on IRS Form 990 and the Schedule J of Form 990
- 240 coaches and athletic directors across Division 1 Football Bowl Subdivision receive more than $1 million in compensation.[2]

Source: [1]http://leimbergservices.com/all/LISIKidwelIGeeraertsMagnerPDF4_10_2018.pdf; [2]USA Today, NCAA Salaries; http://sports.usatoday.com/ncaa/salaries/; http://sports.usatoday.com/ncaa/salaries/mens-basketball/coach/

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Salary Comparisons

NCAAF Coaches

NCAAB Coaches

https://www.usatoday.com/picture-gallery/sports/ncaaf/2018/10/03/college-football-highest-paid-coaches/1497065002/

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Other Uses of Split Dollar Life Insurance

- Charitable Giving
- To Fund a Buy Sell Arrangement
- Private Family (Intergenerational) Split Dollar
- Funding Private Placement Life Insurance (PPLI)

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Advanced Planning Strategy

Private Placement Life Insurance

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What Is Private Placement Life Insurance

- PPLI is a variable life insurance policy that provides cash value appreciation based on segregated investment accounts and a life insurance benefit
  - The objective is to maximize investment returns by being more tax efficient and minimize death benefit. Offers more extensive investment options including alternate asset classes.

Imagine…
A diversified portfolio structure, net of costs, that has the federal and state governments actually paying your HNW, high-income clients (through tax savings) to increase family wealth by millions of dollars (through a death benefit).

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PPLI Advantages

- PPLI is generally owned or placed in an ILIT, an usually designed as a grantor trust;
- PPLI premiums are often substantial;
- PPLI products can provide greater flexibility in allocating contract values among new investment options as events and circumstances change; and
- PPLI fees and expenses tend to be lower than traditional life insurance products.

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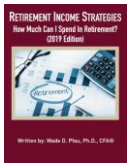

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California	16	Massachusetts	20	Pennsylvania	20
Colorado	20	Michigan	20	Rhode Island	20
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Idaho	20	New Hampshire	20	Virginia	20
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