

## PRIVATE SPLIT DOLLAR

**BY SPLITTING A LIFE INSURANCE POLICY'S PREMIUM AND DEATH BENEFIT BETWEEN YOUR CLIENT AND HIS OR HER IRREVOCABLE-TRUST YOU CAN HELP YOUR CLIENT MINIMIZE OR AVOID GIFT TAXES.**



Many high net worth (HNW) clients need help transferring wealth to the next generation. Many HNW Americans are likely to turn to life insurance to provide liquidity for their estates. Such estate plans often involve millions of dollars worth of life insurance. Surprisingly, the real problem is not how to provide the appropriate liquidity for estate planning, but how to structure an arrangement to minimize or avoid

gift taxes and estate taxes. Traditional acquisition of large quantities of life insurance generally involves paying significant gift taxes in addition to the premium outlays.

Private split dollar arrangements are often used in situations where the HNW client has the money to pay premiums and make gifts to the trust but needs a structure to minimize or avoid gifts on transfers of cash to

the trust. Premium payments are not loans, nor are they fully taxable to the client. This approach is described in the 2003 Final Split Dollar Regulations as a non-equity, reportable economic benefit plan, in which the client is treated as receiving an economic benefit only equal to the low term insurance cost of the client's share of the death benefit. The client's trust owns the policy and provides a death benefit to the client equal to the greater of the policy's cash value or total premiums.

An irrevocable life insurance trust is used to ensure that the death proceeds of the policy will be free of federal income and estate taxes.

### ADVANTAGES OF PRIVATE SPLIT DOLLAR

- ◆ A split dollar arrangement enables transfers of cash to a trust to satisfy premiums. Because the insurer's rate tables are used to determine the gift value instead of the premium, the client avoids gift taxes on premiums
- ◆ HNW clients are able to purchase large quantities of life insurance to meet their planning objectives in a tax efficient manner
- ◆ **Fundamentally, the plan works very much like a personal loan but with an economic benefit cost instead of a loan interest component!**

## CASE Study

### This Issue's Case Study - Private Split Dollar

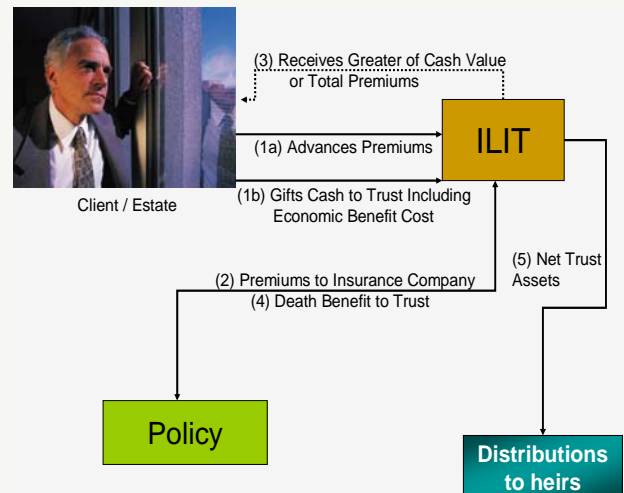
#### Situation

Mr. and Mrs. Client, both age 55, have built a substantial estate. They want to use a combination of earned income and other assets to fund a wealth transfer plan. They have created an irrevocable life insurance trust (ILIT), which has acquired survivorship life insurance. While not sure when they will retire they have decided to fund the wealth transfer plan over the next 10 years.

#### Solution

The client advances premiums (1a) from his estate to an ILIT and gifts cash (1b). The ILIT pays premiums to the insurer (2). At termination of the split dollar plan, in year 11, the estate is to receive back the greater of the policy cash value or total premiums (3). The insurance proceeds are paid to the trust (4) and distributed to heirs (5).

The solution looks like this -



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## Solenture's Private Client Services Practice

Few people have the time to adequately address all of their personal financial goals and objectives. Yet, finding the right advisor to help can be just as challenging. After hearing this issue raised time and again by our clients, Solenture built the Private Client Services Practice.

We work with executives, business owners and high net worth individuals, coordinating with their existing team of advisors, to develop and implement strategies that meet their personal goals and objectives. Work-

ing with our network of financial professionals, we help our clients organize their estate plans, transfer assets to the next generation, aid charity, protect their families, create business succession plans, and invest and allocate assets to meet cash flow needs.

One example of our expertise is advanced life insurance planning. Through the Private Client Services Practice, we offer the following services:

- Financial Planning
- Estate Planning
- Private Business Planning
- Asset Advisory
- Life, Disability and Long-Term Care Insurance
- Life Insurance Consulting and Administration
- Life Settlements
- Re-Engineering Life<sup>SM</sup>
- Private Placement Policies

### Private Split Dollar (continued from Page 1)

#### Illustration of Private Split Dollar

Columns 1-3 illustrate the life insurance policy used in the split dollar plan. Columns 4-5 reflect cash transferred to the trust, which is sheltered from the gift tax using the clients remaining lifetime exemption and annual gift tax exclusions. Note that the premium to satisfy the economic benefit (column 6) is not a gift as it is part of

the split dollar plan. Also of note is that no gift taxes are due (column 8). Amounts gifted to a trust (columns 4-5) are invested in the trust at 5% (column 9) and ultimately used in year 11 as the source of funds to unwind the split dollar plan via repayment of total premiums to client. Columns 13-15 illustrate the cash flows, cash in the trust and rate of return assuming the death proceeds are paid in that year.

Age	Private Split Dollar Arrangement			Gifting From Estate to Irrevocable Trust				Trust Assets				Results at Death			
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
	(Premium) or Recovery of Premiums From Trust	Cash Surrender Value	Death Benefit	Initial Gift to Trust: Using Lifetime Exemption	Annual Gifts to Trust: Using Tax Exclusions	Premium Payment to Satisfy Economic Benefit	Net Gifts to Trust	Total Gift Taxes Due	Trust's Assets Invested	Amount Due to Estate in Given Year to Unwind Split Dollar	Repayment of Premiums to Estate	Trust's Net Death Benefit	Annual After-Tax Outlay: From Estate	After-Tax Cash at Death: In Trust	Internal Rate of Return (IRR)
56	(165,427)	0	10,000,000	(150,000)	(96,000)	(174)	(245,826)	0	258,300	(165,427)	0	9,834,573	(411,427)	10,092,873	2353.14%
57	(165,427)	0	10,000,000	0	(96,000)	(217)	(95,783)	0	372,015	(330,854)	0	9,669,146	(261,427)	10,041,161	363.27%
58	(165,427)	102,181	10,000,000	0	(104,000)	(263)	(103,737)	0	499,816	(496,281)	0	9,503,719	(269,427)	10,003,535	163.02%
59	(165,427)	257,654	10,000,000	0	(104,000)	(307)	(103,693)	0	634,007	(661,708)	0	9,338,292	(269,427)	9,972,299	98.17%
60	(165,427)	420,283	10,000,000	0	(104,000)	(345)	(103,655)	0	774,907	(827,135)	0	9,172,865	(269,427)	9,947,772	67.47%
61	(165,427)	590,441	10,000,000	0	(112,000)	(391)	(111,609)	0	931,252	(992,562)	0	9,007,438	(277,427)	9,938,690	49.91%
62	(165,427)	768,419	10,000,000	0	(112,000)	(458)	(111,542)	0	1,095,415	(1,157,989)	0	8,842,011	(277,427)	9,937,426	38.69%
63	(165,427)	954,536	10,000,000	0	(120,000)	(564)	(119,436)	0	1,276,186	(1,323,416)	0	8,676,584	(285,427)	9,952,770	30.97%
64	(165,427)	1,149,145	10,000,000	0	(120,000)	(719)	(119,281)	0	1,465,995	(1,488,843)	0	8,511,157	(285,427)	9,977,152	25.38%
65	(165,427)	1,352,579	10,000,000	0	(128,000)	(927)	(127,073)	0	1,673,695	(1,654,270)	0	8,345,730	(293,427)	10,019,425	21.17%
66	1,654,270	0	10,000,000	0	0	0	0	0	20,396	0	(1,654,270)	10,000,000	1,654,270	10,020,396	21.02%
70	0	0	10,000,000	0	0	0	0	0	24,791	0	0	10,000,000	0	10,024,791	14.52%
80	0	0	10,000,000	0	0	0	0	0	40,382	0	0	10,000,000	0	10,040,382	8.32%
90	0	0	10,000,000	0	0	0	0	0	65,779	0	0	10,000,000	0	10,065,779	5.89%
95	0	0	10,000,000	0	0	0	0	0	83,952	0	0	10,000,000	0	10,083,952	5.15%

**Notes:** Illustrative only. Actual results will vary based on facts and circumstances. Assumes amount invested in trust earns 5% net of income taxes. Mr. and Mrs. Client are both healthy non-smokers and reside in PA. Assumes that gifts to the trust are sheltered from the gift tax using lifetime exemption or annual gift tax exclusions (split-gifting to four (4) trust beneficiaries).

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