John Hancock INSURANCE

THE JOHN HANCOCK GUIDE TO

Financing Premiums

YOUR BLUEPRINT FOR SUCCESS

LIFE-7299 7/16

WHO WE ARE

John Hancock's Advanced Markets team is recognized as one of the best in the industry. We are a team of attorneys and consultants with a strong background in all facets of estate and business planning. We are constantly educating ourselves on the latest tax, legal, and legislative issues that could impact you and your clients. What differentiates us from other Advanced Markets groups? Real-world experience.

Attorneys

Our attorneys came to John Hancock from top law firms across the country. Their actual practice experience means that they understand not only your clients' needs, but also what motivates attorneys. This knowledge can be the extra advantage you need to help you close the sale.

Advanced Markets Consultants

Our Advanced Markets Consultants have over fifty years of sales and field experience among them and hold CLU®, ChFC®, CFP®, and FLMI® designations. They can help design and illustrate a case that meets your clients' needs, and offer support and insight in overcoming common client objections.

HOW WE CAN HELP

Case Design and Consultation

Our attorneys and consultants are available to help you with all stages of the sale. Whether you need just a quick consultation or a full-blown analysis, we have the tools you need. From fact-finding, to exploring planning options, to illustrating the case, we will help you every step of the way.

Advanced Planning Tools

John Hancock's Advanced Markets team has many tools available to help you with your cases. Most of our tools and calculators produce a client-approved presentation that helps you illustrate the specific case design and highlight options for your client.
Our tools include:

1) **Calculators:** Our online calculators can help with everything from estate tax calculations, business valuation, retirement needs shortfall and personal life insurance needs.

2) **JH Solutions:** This is our flagship proprietary concept illustration software. It creates custom solutions based on your client's needs. Whether you need to illustrate financing strategies, business planning strategies, or other individual strategies for your clients, with over 40+ concepts available, we can help in the design and creation of a custom package.

Contact Advanced Markets
1-888-266-7498
Option 3 — Consultants
Option 4 — Attorneys

TABLE OF CONTENTS

The John Hancock Guide to

Financing Premiums

YOUR BLUEPRINT FOR SUCCESS

Planning involving life insurance financing techniques is similar to building a home. The first step in any financing arrangement, like building a house, is to build a solid foundation. And just as a home's foundation does more than hold the house above ground, such as shield it from forces of nature, the foundation of a financing arrangement should do more than just enable the purchase of a life insurance policy. A strong foundation in this regard offers income and gift tax efficiency, creditor protection, multi-generational planning, and more.

To build the home, the buyer will typically use some type of financing to complete the transaction. The same is often true when working with clients looking to purchase large life insurance policies. Although clients (and advisors) may be more familiar with mortgage financing associated with home purchases or other types of borrowing, many of these principles are applicable to financing substantial insurance premiums.

This guide gives you an expansive overview of financing techniques typically used when affluent clients are purchasing life insurance outside of their estates. It can be used as your blueprint to build a strong foundation and implement a plan that meets your clients unique goals and needs.

How to use this Guide

If you are new to advanced estate planning techniques and financing principles, start with the Foundational Concepts section, which provides valuable and critical information on trusts, gifting, loan arrangements and exit strategies — concepts that will be discussed often throughout the rest of this Guide.

Once comfortable with the Foundational Concept principles, take a look at the section on Choosing a Financing Technique for a quick summary of which techniques work best based on the unique make-up of your client's estate.

This Guide is separated into seven key parts:

- **I** **Foundational Concepts**
- **II** **Choosing a Financing Technique**
- **III** **Private Financing**
- **IV** **Sale to an Intentionally Defective Grantor Trust**
- **V** **Commercial Premium Financing**
- **VI** **Dual Loan**
- **VII** **Private Split Dollar**

Why do affluent clients purchase permanent life insurance?

High net worth clients purchase permanent life insurance policies to ultimately leave a lasting legacy to benefit the ones they love: their children, grandchildren, and other heirs. The following are additional and valuable aspects of permanent life insurance.

LIQUIDITY

A life insurance policy can help provide the liquidity to:

- **Pay for federal or state estate taxes.** Estate taxes are generally due 9 months after death. Having cash available to the estate can help prevent a "fire sale" of assets that may otherwise be required to raise money to pay the estate tax. Even if a client's estate will not be subject to federal estate taxes, it may be subject to state estate taxes.
- **Help equalize an estate among beneficiaries.** Estate equalization often is an issue when (i) there is a family-owned business where only some family members participate in the business or (ii) there is a blended family.

TAX EFFICIENCY

To mitigate or minimize taxes, life insurance provides:

- An income-tax free death benefit;[1]
- Cash value that grows tax-deferred; and
- Cash value access (through loans and withdrawals) that can be tax-free.[2]

COMPETITIVE INTERNAL RATE OF RETURN

Life insurance can provide a competitive rate of return.

- It is not unusual for the rate of return on life insurance proceeds to exceed 6% at life expectancy. Because the proceeds of insurance are received income-tax free, this return is comparable to a return of approximately 9% on another type of investment that does not have the same tax advantages.[3]

FLEXIBILITY

Permanent policies can offer flexibility, which may prove to be very important when developing and implementing an efficient wealth transfer plan.

- Many permanent policies can be structured so that premiums payments can be varied, allowing the client to pay more or less in a given year, or even skip a premium payment. When it comes to financing premiums, this feature can help the trustee manage investment and interest rate risk. Depending on the state, life insurance death benefit and cash value can be protected from creditors.

Foundational Concepts

IN ORDER TO HELP A CLIENT DECIDE among the various options and alternatives involved with financing life insurance premiums, there are certain foundational principles that must first be understood. For example, to understand how loans can be used to fund life insurance premiums in lieu of making gifts, one must be familiar with gifting. It is also important to understand the different types of loans available and the interest rates associated with those loans. Additionally, an understanding of the types of trusts commonly used in financing scenarios with affluent clients is crucial to helping clients create an estate plan that not only addresses their goals and objectives, but is flexible to changing needs and circumstances down the road.

COMMON REASONS TO OWN LIFE INSURANCE IN AN ILIT

1. Keeping the death benefit outside the client's taxable estate for estate tax purposes
2. Creditor protection
3. The ability to control how the death benefit will be distributed among trust beneficiaries (e.g., spouse, children and grandchildren)
4. Income tax efficiency

Understanding Trust Ownership

Irrevocable Life Insurance Trusts (ILITs)

When a client is looking to finance life insurance premiums, the life insurance generally will be owned outside of their taxable estate in an irrevocable life insurance trust ("ILIT").

An ILIT is a type of irrevocable trust that contains provisions specifically designed to facilitate the ownership of one or more life insurance policies. Assuming the trust is properly structured and managed, the life insurance owned inside the trust (along with any other trust assets) will be excluded from the grantor's estate for estate tax purposes. Exclusion from estate taxes is especially important because the trust will expect to receive a very large insurance death benefit upon the death of the grantor.

Understanding trust ownership is part of building a great foundation for your affluent clients, because trusts can be drafted in ways that offer flexibility in distributions, longevity with regards to how long a trust can exist, and even income tax benefits to the grantor. The following sections will cover some of the popular drafting provisions that are often used in ILITS.

Adding Flexibility and Longevity to Trusts

Spousal Lifetime Access Trusts (SLATs)

A SLAT is an irrevocable trust that gives the trustee the ability to make distributions to the grantor's spouse at any time during the lifetime of the spouse. Although the trust may be created to ultimately benefit children, grandchildren and other descendants, a SLAT allows the trustee to make distributions to the grantor's spouse should the spouse need supplemental income and/or access to trust assets. The trust can be drafted to provide distributions to the spouse during the grantor's lifetime for health, education, maintenance or support, if necessary, or can be drafted more broadly to give an independent trustee absolute discretion to make distributions of income and/or principal to the spouse.

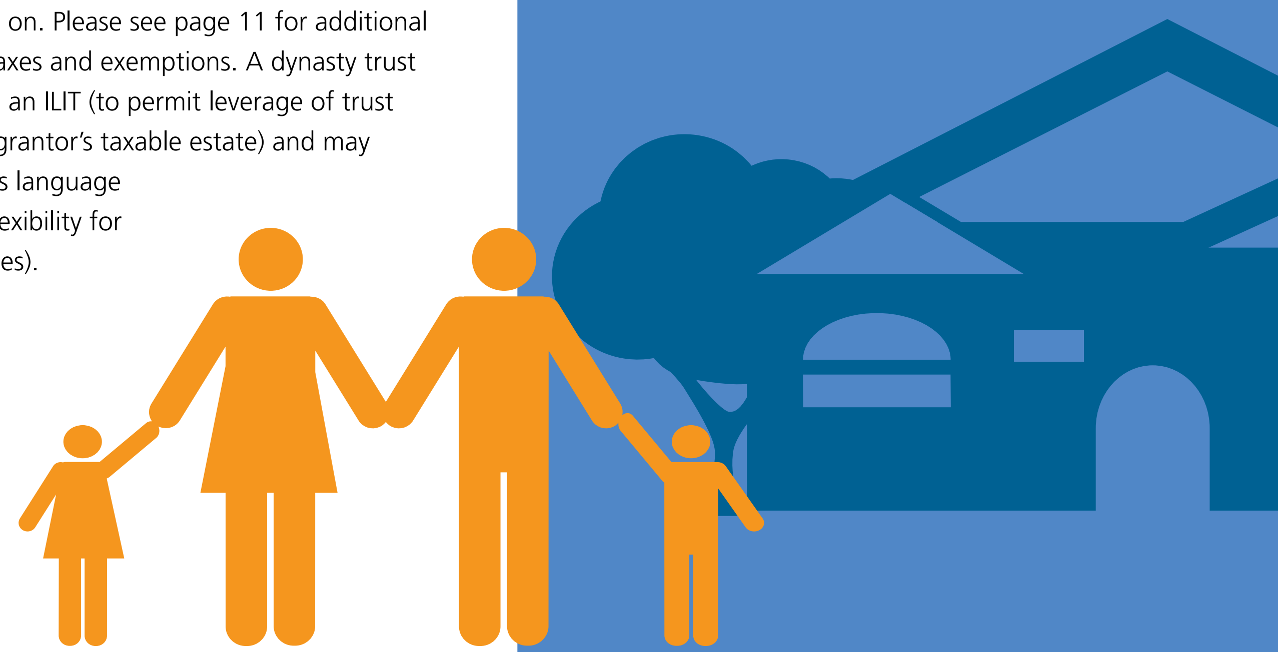
Oftentimes an ILIT will include spousal access provisions, thereby making the ILIT also a SLAT.

Dynasty Trusts

A dynasty trust is a long-term trust created to maximize the transfer of wealth from generation to generation while minimizing (or eliminating) the impact of the generation skipping transfer (GST) tax and the estate tax. The beneficiaries of this type of trust are usually the grantor's children (for their lives) and then grandchildren, great grandchildren, and so on. Please see page 11 for additional information on GST taxes and exemptions. A dynasty trust will very often also be an ILIT (to permit leverage of trust assets outside of the grantor's taxable estate) and may contain spousal access language (to maximize future flexibility for changing circumstances).

WHY INCLUDE SPOUSAL ACCESS LANGUAGE

Spousal access provisions in a trust are often recommended, even if the trust is intended to be primarily for the benefit of beneficiaries other than the spouse, because of the flexibility and availability of funds offered by such provisions. In fact, many clients are more motivated to implement trust and insurance planning when the trustee has the ability to make distributions to the grantor's spouse should unforeseen future circumstances necessitate a distribution, e.g., tax law changes, client's estate drops below the taxable level, etc.



The Power of Grantor Trusts

Generally speaking, when a client is implementing a plan where he or she is financing premiums, the ILIT that will own the life insurance will often contain "grantor trust" language.

GRANTOR TRUSTS

Every trust has a "grantor," but not every trust is a grantor trust. A grantor trust – also commonly referred to as an "intentionally defective grantor trust" (IDGT) – is a type of irrevocable trust that contains certain provisions or powers that cause the grantor of the trust to be treated as the owner of the trust assets, but only for *income tax purposes*. For estate tax purposes, assets held inside the trust remain outside of the grantor's taxable estate. Consequently, the trust is referred to as being "defective" because the grantor must pay all income taxes associated with trust assets despite the fact that the grantor does not actually own these assets or control them.

Why would a grantor want to intentionally create a "defective" grantor trust?

1. **To allow trust assets to grow more rapidly:** If the grantor, rather than the trust, is responsible for paying all income tax on income earned by the trust, then the trust assets can grow essentially tax-free. Additionally, the grantor's payment of taxes on behalf of the trust is not considered a gift.[4]
2. **To transfer assets or income without recognizing gain:** Because a grantor trust is completely disregarded for most income tax purposes, transactions between the grantor and the grantor trust can be done without incurring any additional income tax to the grantor. For example, if the grantor sells a capital asset worth $1,000,000 to his grantor trust, the grantor does not have to recognize gain on the sale of that asset (as otherwise would be required) because the grantor and the grantor trust are deemed to be one in the same for income tax purposes – i.e., the sale is ignored for income tax purposes because the grantor cannot sell an asset to himself/herself. Additionally, if the trust purchases that asset in return for a promissory note and pays interest on that note, the interest payment to the grantor is also ignored for income tax purposes.

HOW IS A GRANTOR TRUST CREATED?

The powers or provisions most commonly used by attorneys when drafting an ILIT to create grantor trust status include:

- A POWER held by the grantor to reacquire the assets in the trust by substituting other assets of equal value
- The POWER held by a non-adverse trustee to make loans to the grantor or grantor's spouse without adequate interest or adequate security
- The POWER to add additional beneficiaries to the trust – e.g., adding a charitable beneficiary
- The RIGHT for trust income to be applied to pay premiums on a life insurance policy insuring the life of the grantor or the grantor's spouse

NOTE: As a best practice, two or more of these powers are often included in the trust document.

Trust Funding

Once a client decides on the type of trust to implement, the next step is determining how to fund the trust. Typically there are three options:

1. BASIC GIFTING
2. FINANCING TECHNIQUES
3. SOPHISTICATED ESTATE PLANNING TECHNIQUES

Gifting is often the preferred method of funding trusts as it is a straightforward and uncomplicated transaction. However, if the client has exhausted his or her lifetime exemption or does not want to make irrevocable gifts, other funding methods are typically explored.

BASIC GIFTING

For gift tax purposes, most gifts can be broken down into three categories — lifetime exemption gifts, annual exclusion gifts, or taxable gifts.

LIFETIME EXEMPTION GIFT: Each person subject to U.S. federal gift and estate taxation has the ability to give away a certain amount of property, during life or at death, without incurring any gift, GST, or estate taxes. These amounts are commonly referred to as the exemption amounts – one for gift and estate taxes (the "lifetime" exemption) and another for GST taxes – and only gifts made in excess of these exemptions are taxable. Under current law, the exemption amounts start at $5,000,000, but are indexed for inflation each year.

PLANNING NOTE

Gifts between married persons (who are both US citizens) generally are not subject to gift tax so that property may pass freely between spouses (both during life and at death) without being subject to tax.

EXEMPTION AMOUNTS

	GIFT & ESTATE EXEMPTION	GST EXEMPTION
2011	$5,000,000	$5,000,000
2012	$5,120,000	$5,120,000
2013	$5,250,000	$5,250,000
2014	$5,340,000	$5,340,000
2015	$5,430,000	$5,430,000
2016	$5,450,000	$5,450,000

PLANNING NOTE

For a gift to an ILIT to qualify as an annual exclusion gift, the trust usually will give each beneficiary the right to withdraw the amount gifted for a small period of time (e.g., 30 days). After the time period expires, the gift can be used by the trustee for other purposes – e.g., paying the life insurance premium. This withdrawal provision is usually referred to as a "Crummey" power.

ANNUAL EXCLUSION GIFTS: In addition to lifetime exemption gifts, each individual has the ability to give an annual gift of $14,000 in 2016 (indexed for inflation) to another individual each year without incurring any gift taxes. Thus, a person can give $14,000 ($28,000 for married couples) to as many individuals as he/she wishes, each year, and this gift is neither taxed nor subtracted from their lifetime exemption. The annual exclusion represents a very valuable opportunity to gift property to a trust, because the donor can make annual gifts of $14,000 to each beneficiary of the trust, which can add up quickly depending on the number of beneficiaries.

It also should be noted that married couples are allowed to "split" their gifts and treat them as if one-half came from each spouse, even if one spouse made the entire gift.

TAXABLE GIFTS: If an individual gives away an amount that exceeds his or her lifetime exemption, and/or annual exclusion, future gifts are subject to gift tax. The current gift tax rate is 40% and the person making the gift (the donor) is responsible for paying the tax.

FINANCING TECHNIQUES

If making gifts to the trust is limited or undesirable, the client should consider one of the following financing options explored in this Guide:

- Private Finance
- Dual Loan
- Sale to an Intentionally Defective Trust
- Commercial Premium Finance
- Private Split Dollar

SOPHISTICATED PLANNING TECHNIQUES

There are many other advanced planning techniques that may be used to help fund a trust, including:

- Grantor Retained Annuity Trusts (GRATs)
- Charitable Lead Trusts (CLTs)
- Qualified Personal Residence Trusts (QPRTs)

Although a discussion of all advanced estate planning funding techniques is beyond the scope of this Guide, some of these concepts will be discussed under "Common Exit Strategies." Please see page 17.

Basic Loan and Sales Principles

If a client does not want to use their lifetime exemption and/or has inadequate available exemption remaining, techniques to finance premiums should be considered. In order to explore the financing options available, it is important to understand some basic loan and sales principles.

RESPECTING THE FORMALITIES OF A SALE/LOAN

The formalities of a sale or a loan must be strictly observed to avoid the transaction being suspected as a disguised gift; especially when the seller or lender is the grantor of the trust or other related party.

Some of the factors the IRS may consider to determine if a transaction is true debt and not a disguised gift include whether:

- There was a written promissory note
- Appropriate interest was charged
- There is a fixed maturity date or repayment schedule
- Collateral was given as security
- There was a reasonable expectation of repayment
- Repayment was actually made
- The parties treated the transaction as a true loan/sale

FOR EXAMPLE

If the grantor lends money to his or her own trust, but charges the trust a rate of interest that is below the required "market" rate, the IRS will consider the foregone interest to be a gift from the grantor to the trust.

Even worse, ignoring the formalities of the transaction may allow the IRS to disregard the transaction entirely and treat the sale or loan as a taxable gift.

Promissory Notes

A sale of an asset requires the transfer of the asset in exchange for cash, a promissory note of equal value, or some combination of the two. Likewise, a loan is the transfer of cash to the borrower for a note of equal value. In both instances, a promissory note is given to the transferor to legally acknowledge that the buyer/borrower owes money in exchange for having received the asset or cash. Similar to a promissory note that one would sign when borrowing from a bank or other third-party lender, a promissory note associated with the sale of an asset or loan from the grantor (or other related party) to a trust typically will include the following information:

REPAYMENT OBLIGATION

The promissory note should clearly state the specific dollar amount that the borrower owes to the lender. This is commonly referred to as the "face amount" or the "principal" of the note.

INTEREST RATE

The promissory note must state an applicable interest rate, which represents a charge to the borrower for the use of an asset/cash prior to repayment of the debt. The interest rate generally is expressed as a percentage of principal. See page 15 for more information about interest rates.

DATE OF REPAYMENT

The promissory note should provide a date upon which repayment of the debt must be satisfied. Typically, a note will be characterized as either a "term" loan or a "demand" loan, based on when the borrower is required to pay back the lender.

- **A TERM LOAN** sets a specific term or time period for when repayment is due. Such a term may be stated as a number of years (e.g., 10 years) or upon the occurrence of a specific event (e.g., death of the lender). Although typically a borrower will have the option to repay the note early, a term loan does not allow the lender to demand repayment prior to the end of the term.
- **A DEMAND LOAN** means that the repayment obligation may be called by the lender, in full, at any time.

Interest Rates – The "Cost" of Money

If a grantor lends money to a trust, the cost to the trust of borrowing this money is captured as an interest rate. For transactions between related parties – e.g., between a grantor and his trust – the IRS publishes interest rates each month that it considers to be adequate for such sales or loans. These interest rates are known as the "applicable federal rates" (AFRs) and are generally used as follows:

AFR TYPE	LOAN TYPE
SHORT-TERM RATE	Used with term loans with a term of 3 years or less.
MID-TERM RATE	Used with term loans with a term between 3 and 9 years.
LONG-TERM RATE	Used with term loans with a term exceeding 9 years.
BLENDED RATE	Used with demand loans.

With a term loan, the applicable interest rate will remain fixed for the duration of its term. In comparison, the interest rate on a demand loan will vary each year as the blended rate changes; this rate change reflects the reality that a demand loan is truly only a one-year loan that the lender chooses not to demand payment in a given year.

Typically, the AFR rates and blended rate are well below the loan interest rates charged by traditional lending institutions. As a result, the borrower (e.g., the trust) will reap the benefits of being able to borrow money at a lower rate than can be obtained in the commercial marketplace. This provides the trust with the opportunity to maximize the arbitrage it can receive between the return on the investments held inside the trust and the interest rate due on the promissory note (see page 16 for more information on arbitrage).

PLANNING NOTE

Notes can generally be renegotiated at any time with the consent of all the parties.

FOR EXAMPLE: A grantor may lend money to his/her trust pursuant to a 9 year term note, locking in the mid-term AFR for the term. If the AFRs substantially fall over time, the parties may agree to refinance the note. Changes to the new agreement should be supported by adequate new consideration (i.e., the grantor must be able to justify why they are willing to accept less interest from the trust under the new loan).

FOR INFORMATION on current AFR rates go to https://apps.irs.gov/app/picklist/list/federalRates.html

Paying Premiums with Arbitrage

In a financial setting, arbitrage is designed to take advantage of different rates of earnings and cost.

FOR EXAMPLE

An investor may borrow $1,000 at 5% annually, but invest the loan proceeds in a way that yields an after-tax return of 7.5%. This lender will earn $75/year and owe interest of $50/year, producing a net profit of $25/year, using none of the investor's own money. Because this concept can be employed to generate wealth where there was none before, it has been very successfully used to produce value inside an ILIT without gifting, and therefore without incurring gift, GST, or estate taxes. This value can then be leveraged to substantially greater amounts by applying it to life insurance premiums.

HYPOTHETICAL CASE STUDY

Gary is a successful businessman who owns various profitable business interests and has large cash holdings. He has a need for life insurance to be owned in trust so that it will be beyond the reach of his creditors and will not be subject to estate taxes. Gary has also used all of his available gifting.

GARY WEIGHS HIS OPTIONS

X He could create a trust and give money to the trust to pay premiums on a life insurance policy on his life, but that would result in gift taxes.

X He could lend his trust the annual premium and in turn avoid having to pay gift taxes, but the loans would aggregate and then have to be repaid from the death benefit, which would reduce the amount available for the trust beneficiaries.

✔ He could use **ARBITRAGE** and lend a large lump sum to his trust at a rate equal to the AFR. The trust could then invest the loan proceeds in such a way as to maximize their earning potential. The earnings from the trust investment would be applied first to pay loan interest due back to Gary, and the balance would be available to pay premiums on a life insurance policy on Gary's life. Because the premiums and debt service are paid entirely out of the investment earnings of the trust, the original loan proceeds are always available to pay off the original loan from Gary.

Common Exit Strategies

Few arrangements are designed to last forever, and for this reason, it is important to consider at the beginning of a financing arrangement how it will end. In an arrangement created to provide financing of life insurance premiums, the primary goal of the exit strategy is to provide sufficient liquidity to repay the outstanding debt at a specific time in the future.

1 DEATH BENEFIT

Arguably one of the simplest exit strategies is to repay financing indebtedness with life insurance proceeds payable upon the death of the insured. This exit strategy may be particularly advantageous for an estate that will need liquidity at the grantor's death to pay estate taxes, equalize an estate, etc. as the debt is repaid with cash from the insurance policy. However, this strategy may not be ideal in cases where the trust needs most or all of the death benefit for other purposes, when the grantor wants to be repaid sooner, or when the lender is someone other than the insured. Consequently, relying on death benefit proceeds to repay debt may work best:

- For older insureds
- When substantial liquidity is needed in the estate for estate tax or other purposes
- When a return of premium (ROP) rider is used

2 RETURN OF PREMIUM RIDER (ROP)

Some life insurance policies offer a "return of premium" (ROP) rider, which increases the initial death benefit by a portion of the premium paid (up to 100% of the premium). By adding this rider to a life policy, the death benefit received by the ILIT will be increased by an amount equal to cumulative premiums paid (or a percentage thereof, depending on the ROP used), which allows the ILIT trustee to repay any outstanding indebtedness without reducing the original death benefit intended for the ILIT beneficiaries. This rider, however, comes at a cost as premiums generally will be much higher than a policy without such a rider.

3 POLICY CASH VALUE

Permanent life insurance policies can be designed to grow cash value that may be used to repay part or all of a lending arrangement via policy loans or withdrawals. While growing sufficient cash values to accomplish this may take time, it provides the ILIT trustee the option to use some or all the cash value built up inside the policy to support the repayment of the indebtedness at some future date. The risk to this approach is that typically cash value growth cannot be guaranteed and is subject to investment and/or crediting rate risk (depending on the type of policy). Consequently, there is no guarantee that enough cash value will be available to repay the debt. Moreover, once the ILIT accesses the policy cash value, the policy's death benefit will decrease, leaving less death benefit for the ILIT beneficiaries.

GRANTOR RETAINED ANNUITY TRUSTS (GRATS)

A GRAT is an irrevocable trust into which an individual transfers property and retains the right to receive a fixed dollar amount (the "annuity") from the trust each year for a specified term of years. At the end of the term, any property remaining in the GRAT passes to the remainder beneficiary – e.g., the ILIT – and the ILIT Trustee can use this remainder to help repay any outstanding debt obligation.

For gift tax purposes, the value of the gift is the present value of the property transferred less the present actuarial value of the stream of annuity payments based on interest rates published monthly by the government under IRC §7520 (the "Section 7520" rate). Often, the GRAT is designed so that the value of the stream of annuity payments is identical to the value of the transferred property, resulting in no gift (or a very minimal gift) to the trust.

CHARITABLE LEAD TRUSTS

Similar to the GRAT strategy discussed above, the Charitable Lead Trust ("CLT") is a discounted giving technique with a charitable twist, and may be especially attractive to charitably inclined clients. The grantor creates a CLT and names a charitable beneficiary and a non-charitable remainder beneficiary. For a term of years, the charitable beneficiary will receive a specified annual payment. At the end of that term, the CLT will terminate and whatever remains in the trust on that date will be distributed to the remainder beneficiary. Thus, the grantor has made two gifts presently of separate future interests:

1. A gift to the charity of the annuity payments
2. A present gift to the non-charitable beneficiary of the future interest in the trust remainder

The value of the taxable gift to the non-charitable beneficiary is reduced by the present value of the charitable annuity and discounted as a future interest (a right to be paid years after the gift is made). As with the GRAT, the taxable gift may be reduced by the discounts to be zero. To the extent that the CLT realizes the greater of earnings or appreciation than the assumptions anticipated, the remainder beneficiary (e.g., ILIT) will receive the liquidity needed to roll out of a financing arrangement. As an additional benefit, incorporating a CLT as part of the client's planning may provide the client with a valuable income tax deduction associated with the portion of the trust that will benefit the designated charity.

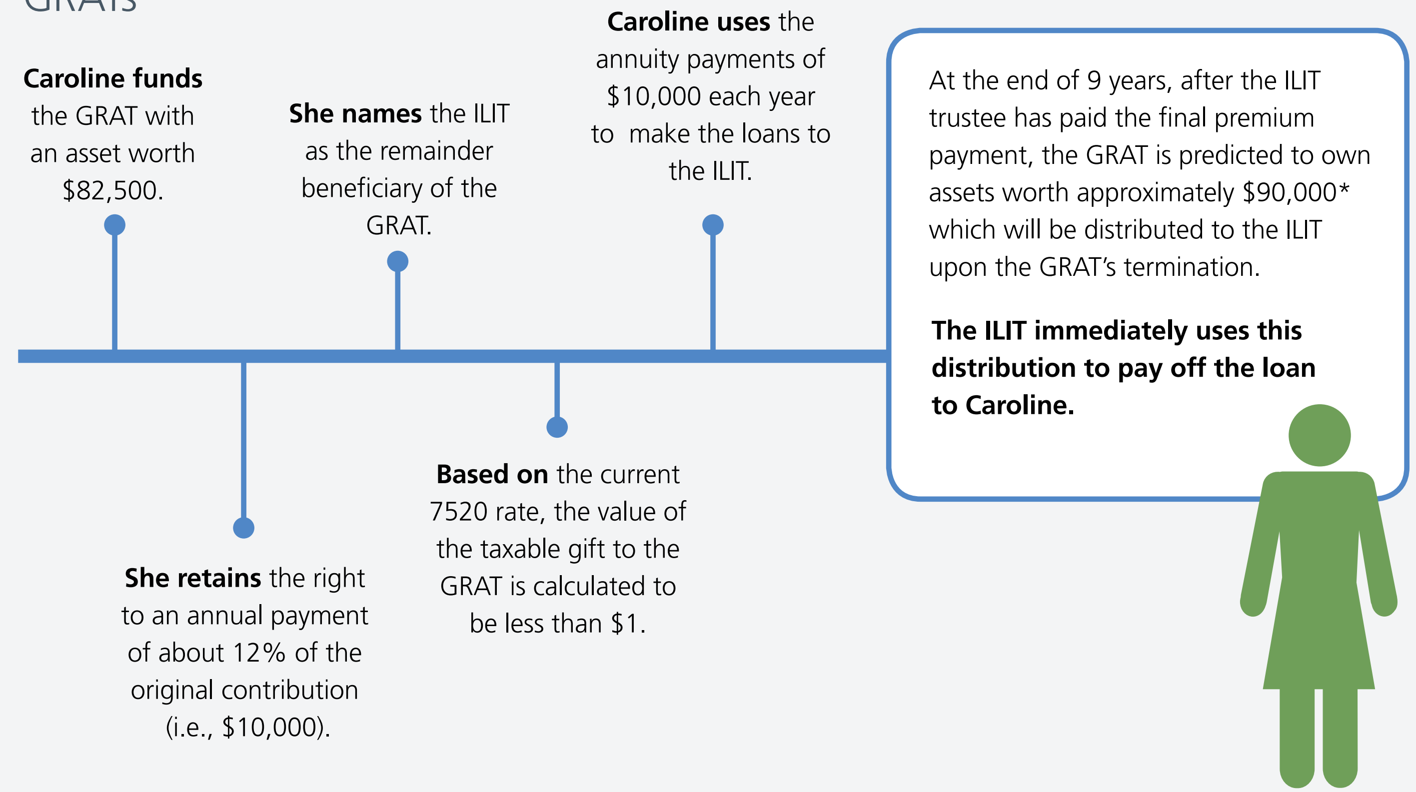
ANNUAL EXCLUSION GIFTS

Sufficient liquidity to fund the exit from a financing arrangement can also be built up gradually using annual exclusion gifts. If annual exclusion gifts are made to a trust over many years, these gifts (and the earnings associated therewith) will grow and be available as liquidity to retire any outstanding debt made to finance life insurance in the ILIT.

HYPOTHETICAL CASE STUDY

SITUATION: Caroline creates an ILIT, which will purchase a life insurance policy with a 9 pay premium and at the same time that the ILIT is created, she will simultaneously create a nine-year GRAT.

HOW IT WORKS
GRATs



BENEFITS OF GRATS

The ILIT now owns a fully paid-up life insurance policy, and Caroline has received back all of the original assets. Most importantly, no gift or estate taxes have been incurred.

*Assumes the assets inside the GRAT appreciate at 6.5% a year over the term of the GRAT.

SUMMARY

These foundational principles are imperative to creating and implementing a successful financing technique. Once this solid foundation has been built, advising clients about what type of financing option may work best becomes much easier and will largely depend on the type of assets the client owns and the ability to make gifts.

Choosing a Financing Technique

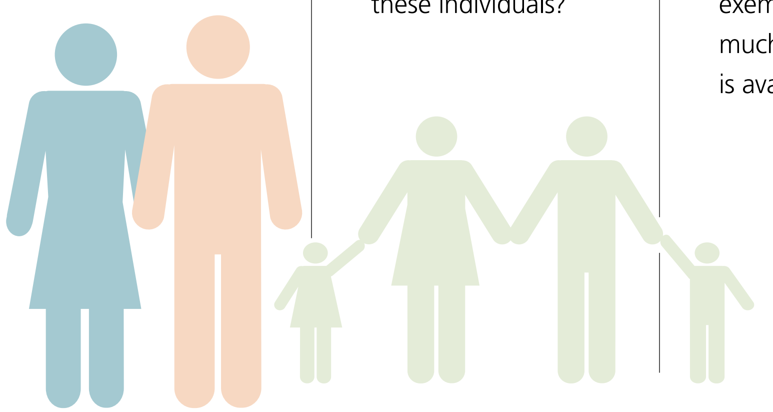
HERE ARE SOME KEY QUESTIONS to ask your clients to start the financing conversation and help them choose the right technique for their planning needs.

STEP 1:

Assess the client's ability to make a gift.

(If you know client has no gifting available, move to Step 2.)

- How many children or grandchildren does the client have?
- Does the client already make annual exclusion gifts to some or all of these individuals?
- Has the client made any gifts that have reduced his or her lifetime exemption? If so, how much exemption, if any, is available?
- Does the client have any existing trusts? If so, how were they funded and what type of assets do these trusts own? Are they grantor or non-grantor trusts?
- If the client has gifting available, is he or she opposed to making gifts that will reduce his or her lifetime exemption?



Ultimately, you are looking to get a pulse check on the client's ability and willingness to make gifts.

This is also a great way to uncover prior planning done by the client and find "hidden" assets that are already outside of the estate, but may be available to help fund the purchase of life insurance.

If the client is open to making gifts, it is generally prudent to start a conversation about paying premiums using some type of gifting.

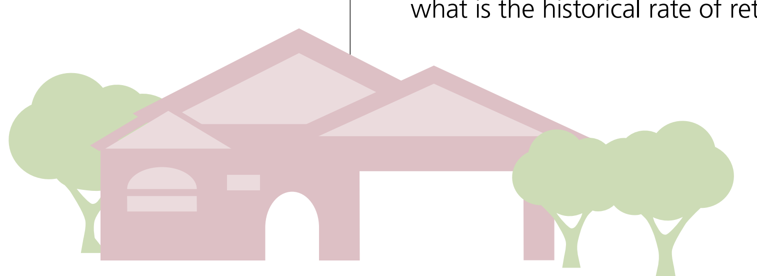
2x **Also, remember** that with married couples, gifting amounts are doubled so there may be more exemptions available.

STEP 2:

Assess the client's estate to determine which financing technique may be a viable option.

(If the client does not have gifting available, the good news is that there are many financing options available. However, in order to narrow down the options, there needs to be some fact finding to understand the make up of the client's estate.)

- Is there liquidity in the client's estate? How much cash does the client have on hand?
- What types of assets are held in the estate — real estate, securities, business interests, etc.? What is the rate of appreciation on these assets? Are these assets producing income? If so, what is the historical rate of return?
- Are there any restrictions that would prevent the client from transferring these assets into a trust, even for a short period of time?
  - Restrictions might include:
    - (i) a transfer restriction on business interests pursuant to an operating agreement or buy-sell agreement; or
    - (ii) asset is subject to debt and cannot be transferred.
- Has the client used credit and loans in the past to build his or her net worth? Does the client have access to a line of credit or a strong banking relationship?

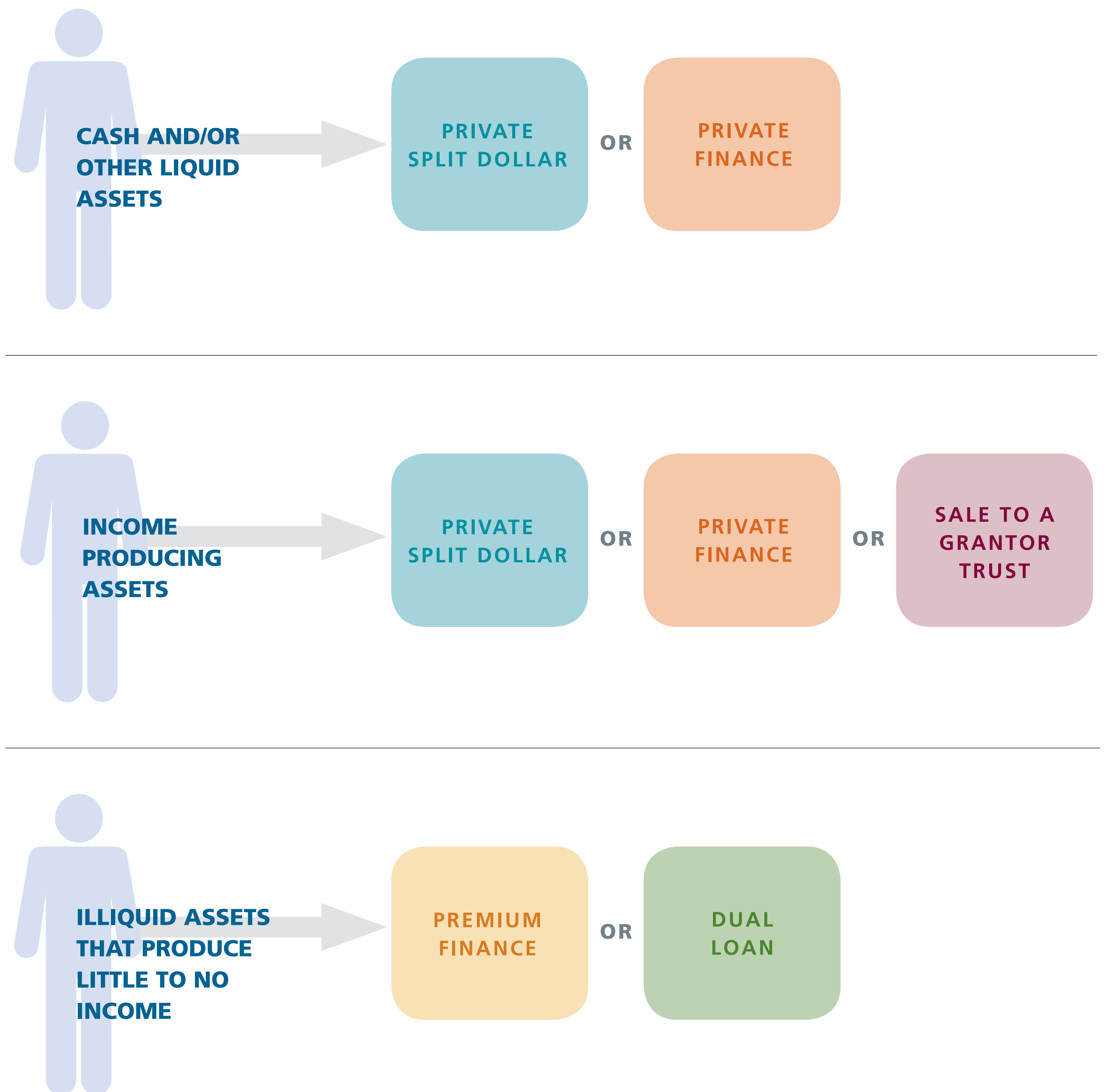


Knowing the type of assets and liquidity held inside the client's estate will be critical to determining whether or not the client is a good candidate for one or more financing strategies.

For example: A client with a lot of liquidity may be best served by using a private financing technique to fund premiums inside an ILIT. Alternatively, a client with little liquidity, but income-producing assets, may benefit from a sale of those assets to a grantor trust.

To help choose a financing technique that is best suited to a particular client, consider the following:

WHAT TYPE OF ASSETS DOES THE CLIENT PREDOMINANTLY OWN?



Private Financing

PRIVATE FINANCING IS THE FUNDING OF LIFE INSURANCE PREMIUMS through a personal loan between a grantor and his or her irrevocable life insurance trust (ILIT).

In this regard, the grantor of the trust acts as the "bank" and lends the ILIT an amount of cash necessary to acquire and make the premiums on a life insurance policy (usually on the grantor's life).

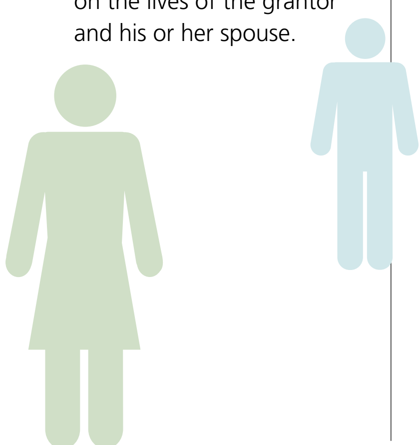
The trustee is usually charged with the management of the loan assets and utilizes the cash lent to the trust to make the premium payments on the life insurance policy.

A LENDING TECHNIQUE THAT:

- **Requires cash**
- **Offers flexibility in plan design**
- **Relies on AFR rates**

HOW IT WORKS

1 **The grantor** creates an ILIT, which will apply for insurance on his or her life; alternatively, a second-to-die policy could be purchased on the lives of the grantor and his or her spouse.



2 **The grantor** then enters into a loan agreement whereby he or she lends money to the trust to pay the insurance premium in return for a promissory note.

- The loan can be paid annually or in a lump sum.
- The note must charge an appropriate rate of interest, e.g., at or above the appropriate Applicable Federal Rate (AFR).

3 **The trust** uses the borrowed funds to pay the insurance premiums. If the trust has borrowed a lump sum amount, any excess funds will typically be invested and/or used to pay interest back to the client each year.

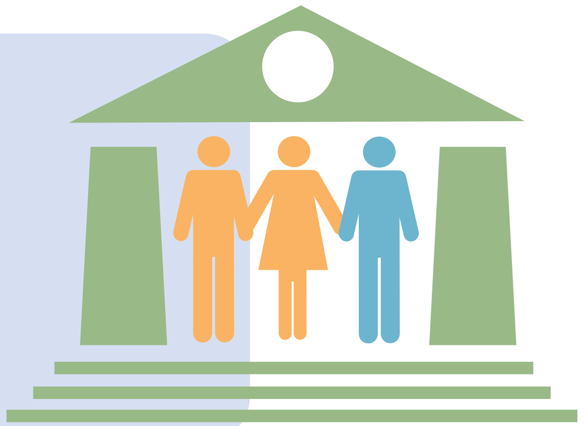
- The insurance policy may be used as collateral to secure the loan; the grantor's attorney should determine if collateral is necessary.

4 **At the end of the loan period,** the trust repays the debt using assets held in the trust.

WHO CAN BE THE LENDER?

When appropriate, the following parties may also be potential lenders to an ILIT:

- A parent or grandparent of the grantor
- A previously established trust created by the grantor
- A trust where the grantor is a beneficiary
- A family limited partnership or other family entity with liquidity



Loan Terms

One of the most appealing aspects of private financing is the flexibility provided to both the grantor and the trustee in arranging the type and term of the loan. Some of the factors to consider include:

SIZE OF THE ANNUAL PREMIUM

Often, the larger the premium, the longer the loan term will be.

DURATION OF PREMIUM PAYMENTS

In many cases, the loan term will match the number of premium payments on the policy. While this is not required, most insureds like to see the "entire transaction" terminate at the same time, – i.e., when the premium payments end, the loan is repaid.

CURRENT INTEREST RATE ENVIRONMENT

If the interest rate environment is low and predicted to rise, some planners like to lock in the low rates currently available for as long as possible. If the current rate environment is high and expected to fall, some planners like to go for shorter term loans and refinance the note when interest rates begin to fall.

REPAYMENT EXPECTATION

How long can the client afford to be without the amount loaned? Does he or she have these funds earmarked for a specific future use? In order for the client to embrace a private financing arrangement, you must gauge his or her willingness to be without these cash assets for a period of time.

LIQUIDITY

If the client has substantial liquidity and does not currently need these funds to support lifestyle, repay debt, etc., a lump-sum loan with an arbitrage approach should be considered. If the client has less liquidity but has business interest or other assets that are appreciating in value, a smaller lump sum loan or annual loans may be a better fit.

Consider how each of these factors play a role in the following case studies, which represent some of the most popular case designs for this technique.

Lump Sum Loan Approaches

SCENARIO 1
Paying Premiums With Arbitrage

Molly and Liam Fitzpatrick, an affluent married couple both age 65, have a life insurance need of $2,000,000. They would like to leverage their assets to pay for the insurance premiums without using any of their lifetime exemptions. **Molly lends $1,000,000 to her ILIT in return for a promissory note with a 1.4% mid-term AFR interest rate and 9 year term.** The trustee invests the $1,000,000 into a commercial bond that pays an annual income amount of 6% (or $60,000) per year. The life insurance policy design reflects a 9 year annual premium of $46,000 on a survivorship policy on Molly and Liam's life with a death benefit of about $2,000,000. The trustee will use the $60,000 of annual cash flow to:

- Make annual loan interest payments of $14,000 to Molly
- Pay the $46,000 insurance premium each year for 9 years

At the end of the 9 years, the original $1,000,000 borrowed is used to repay the loan. See chart below.

YEAR	OUTSTANDING LOAN AMOUNT	ANNUAL LOAN INTEREST AT 1.4%	ANNUAL INSURANCE PREMIUM	TRUST FUND GROWTH AT 6%	LOAN REPAYMENT	TRUST SIDE FUND	LIFE INSURANCE DEATH BENEFIT
1-8	$1,000,000	$14,000	$46,000	$60,000	—	$1,000,000	$2,000,000
9	$1,000,000	$14,000	$46,000	$60,000	$1,000,000	—	$2,000,000

As illustrated, this strategy did not require the grantor to use any annual exclusion gifts or lifetime exemption gifts in order to fund the policy inside the trust. The policy is funded solely from the investment return on the borrowed amounts.

POTENTIAL RISK AND SOLUTIONS TO MITIGATE THE RISK

This example reflects a fixed loan interest rate, fixed life insurance premium, and a fixed loan term; consequently, the only risk element is the investment return rate.

In the event the investment return is less than the 6% assumed, there are a few options available to minimize the impact:

1. MAKE GIFTS TO COVER THE "SHORTFALL"

Molly could make annual exclusion gifts and/or gifts using her lifetime exemption to cover the amount of the shortfall. This may come in the form of Molly actually gifting money or assets to the trust or could result from her forgiving some of the debt. The grantor may even consider making annual exclusion gifts each year, regardless of return on the investments inside the trust, to help build a side fund to cover any unexpected shortfalls in the future.

2. REFINANCE THE NOTE

Molly, as the lender, and the trustee may arrange to refinance the original note under a new loan arrangement for an extended loan period at a new AFR interest rate. For example, the parties may decide to refinance the note for another 3 years under a short-term AFR. Because there are no more premiums due by the end of the original loan term, all positive returns on the invested loan assets in the ILIT can be used to make interest payments and repay principal.

SCENARIO 2
Sinking Fund Approach

In this scenario, Molly, lends her ILIT $366,255 (instead of $1,000,000) under a 9 year mid-term AFR Loan at 1.4%. The trustee again invests the borrowed amount (assume a 6% return) and uses the earnings and a portion of the borrowed principal to:

- Make the annual premium payment of $46,000
- Pay the annual loan interest payment of $5,132

As the following chart illustrates, the balance in the trust's side fund slowly decreases each year and is reduced to zero by the end of the loan term.

FIGURE 2

YEAR	OUTSTANDING LOAN AMOUNT	ANNUAL INSURANCE PREMIUM (BOY)	TRUST FUND GROWTH AT 6% (EOY)	ANNUAL INTEREST DUE AT 1.4%	TRUST SIDE FUND (EOY)	LIFE INSURANCE DEATH BENEFIT	TRUST DEATH BENEFIT & SIDE FUND NET OF LOAN
1	$366,555	$46,000	$19,233	$5,132	$334,657	$2,000,000	$1,968,102
3	$366,555	$46,000	$15,291	$5,132	$265,003	$2,000,000	$1,898,448
5	$366,555	$46,000	$10,861	$5,132	$186,741	$2,000,000	$1,820,185
7	$366,555	$46,000	$5,883	$5,132	$98,805	$2,000,000	$1,732,250
9	$366,555	$46,000	$290	$5,132	$0	$2,000,000	$1,633,445

BENEFITS OF LUMP SUM LOANS

- Fixed loan interest rate for the duration of the term — eliminating interest rate risk.
- If desired, client can make gifts to the trust to assist with loan interest repayments or reduce the debt.
- Trustee can invest borrowed amounts in income-producing assets, such as real estate or a securities portfolio, allowing the financial advisor or wealth manager to retain assets under management.

Exit Strategies

Assume Molly and Liam are still alive at the end of year 9 and the trust has no assets (other than the life policy) from which to repay the loan.

In order to repay the debt, one of the following exit strategies may be considered:

GRANTOR RETAINED ANNUITY TRUST (GRAT)

1

Assume in the above example Molly creates a 10 year term GRAT at the same time she lends money to the trust, and names the ILIT as the remainder beneficiary of the GRAT. Grantor transfers $1,130,000 of securities into this GRAT assuming a 2% Section 7520 Rate and a portfolio generating 6% income. Molly will receive 10 annual annuity payments from the GRAT of about $126,000/year and the projected GRAT remainder of $366,555 will be distributed to the ILIT at the end of the GRAT term. The trustee will then use the $366,555 to repay the grantor for the loan, thus completing the transaction.

CHARITABLE LEAD ANNUITY TRUST (CLAT)

2

Use of a charitable lead annuity trust in lieu of a GRAT would effectively work the same way as the GRAT, except the $126,000 annuity payment would be paid to a charity rather than the grantor. At the end of the CLAT term, the ILIT would still receive the CLAT remainder and would use those assets to repay the debt to the grantor on the loan, completing the transaction. Depending on the type of CLAT used (grantor vs. non-grantor), a charitable deduction may be available to Molly for the value of the annuity payments made to the charity.

Utilizing either a GRAT or a CLAT exit strategy as illustrated allows the grantor to pay for the life insurance owned inside the ILIT and be repaid in a short amount of time without having to make any gifts to the trust.

Annual Loan Approaches

SCENARIO 1

Annual Loan Approach

Matt King, age 80, applies for a $2,000,000 life insurance policy with the ROP rider and agrees to enter into an annual private loan arrangement with his ILIT, with each loan payable at his death. The annual premium is $250,000 per year and the death benefit will go up each year by that amount due to the ROP rider. The loan interest will be paid each year via a gift from Matt to the trust. See chart below.

If Matt dies in year 10, at age 90, the trust will receive $4,500,000 of death benefit — $2,500,000 will be used to repay the debt to Matt's estate and the remaining $2,000,000 will stay in trust. **Despite the size of the premiums, Matt only had to use $618,750 of gifting in order to have the trustee purchase the policy inside the ILIT.**

YEAR	ANNUAL PREMIUM LOAN	TOTAL LOAN BALANCE DUE ESTATE	LIFE INSURANCE DB	NET-LIFE INSURANCE DB AFTER LOAN REPAYMENT	ANNUAL INTERST RATE	TOTAL ANNUAL INTEREST GIFT DUE
1	$250,000	$250,000	$2,250,000	$2,000,000	3.00%	$7,500
2	$250,000	$500,000	$2,500,000	$2,000,000	3.25%	$16,250
3	$250,000	$750,000	$2,750,000	$2,000,000	3.50%	$26,250
4	$250,000	$1,000,000	$3,000,000	$2,000,000	3.75%	$37,500
5	$250,000	$1,250,000	$3,250,000	$2,000,000	4.00%	$50,000
6	$250,000	$1,500,000	$3,500,000	$2,000,000	4.25%	$63,750
7	$250,000	$1,750,000	$3,750,000	$2,000,000	4.50%	$78,750
8	$250,000	$2,000,000	$4,000,000	$2,000,000	4.75%	$95,000
9	$250,000	$2,250,000	$4,250,000	$2,000,000	5.00%	$112,500
10	$250,000	$2,500,000	$4,500,000	$2,000,000	5.25%	$131,250
					TOTAL	$618,750

Annual Loan Considerations

- As opposed to lump sum loans, the interest rates on each annual loan will vary.
- Loan interest must be paid each year or accrued. The grantor may gift to the trust each year to help the trust pay the interest, but caution must be used to avoid below-market loan treatment or deferral charges under the Split Dollar Regulations. See §1.7872-15(a)(4) and (h).

COMMON USE OF ANNUAL LOANS

- Short-term loan arrangements where a more permanent source of funding will be available in the future, but insurance coverage is needed/wanted today
- When lender is advanced in age (e.g., 80+ years old)

SUMMARY

As these examples illustrate, Private Financing is a very flexible arrangement which allows a client the opportunity to create a life insurance funding arrangement in a gift tax efficient manner. This technique can be designed to accommodate a client's asset holdings and risk tolerance, and can be done in conjunction with other wealth transfer and estate planning techniques.

Sale to an Intentionally Defective Grantor Trust

SALE TO AN INTENTIONALLY DEFECTIVE GRANTOR TRUST

A SALE OF AN ASSET to an intentionally defective grantor trust ("IDGT" or "grantor trust") takes advantage of grantor trust rules, which allow the grantor to sell assets to the trust without having to recognize gain on the sale.[4]

As long as the trust is structured as a grantor trust, the "sale" is ignored for income tax purposes because the grantor still is treated as the owner of the asset after the sale. By selling assets to a grantor trust in exchange for a promissory note, the grantor can transfer assets to the trust in a gift tax efficient manner and use those trust assets to pay for insurance premiums.

A LENDING TECHNIQUE THAT:

- **Requires income producing assets**
- **Offers flexibility in plan design**
- **Relies on AFR rates**

What type of assets should be sold?

Income producing assets are ideal

- Limited partnership interests
- S-Corporation stock
- Commercial real estate
- Securities and other income generating assets

KEEP IN MIND: The success of the sale to an IDGT strategy is contingent upon the assets growing or producing income at a rate higher than the AFR.

WHY IS MAKING A SEED GIFT IMPORTANT?

If an individual has a retained interest in a transferred asset, the value of that asset will be pulled back into that individual's estate by the IRS.

With respect to a "sale" of an asset between the grantor and his or her trust, if the trust must rely only on the income generated by the asset sold to repay the grantor, the IRS may argue that the transaction is, in substance, a transfer with a retained interest rather than a bona fide sale. This argument is bolstered by the fact that most individuals would be unwilling to sell an asset to another person who has no means to pay for that asset.

Consequently, a seed gift provides the trust with economic substance not directly tied to the asset(s) being sold to help combat an IRS attack and have the transaction be treated as a legitimate sale.

NOTE: If the client has an existing grantor trust that has been previously funded with sufficient assets, a "seed" gift may not be necessary.

PLANNING NOTE

If the grantor wants to create a multi-generational trust that is exempt from the generation-skipping transfer (GST) tax, he or she should allocate the GST exemption to the seed gift.

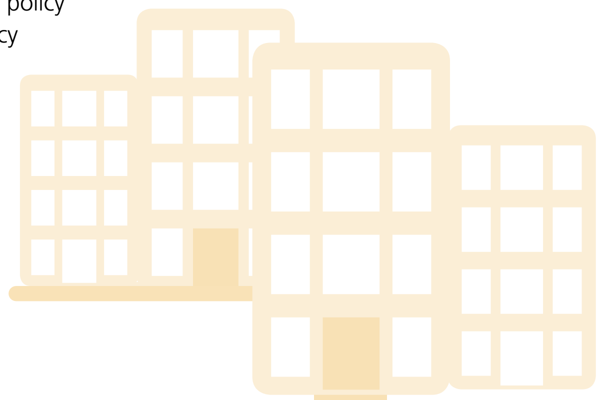
MORE INFORMATION on grantor trusts can be found in the Foundational Concepts section of this Guide.

HOW IT WORKS

1. **The grantor creates an ILIT** that incorporates certain powers or provisions that will cause the trust to be considered a grantor trust.

2. **The grantor funds the trust with an initial "seed" gift of cash and/or assets.** Although it has become common practice to make a "seed" gift equal to at least 10% of the installment purchase price, not all attorneys follow this practice.

3. **The grantor sells the targeted income-producing asset** for its fair market value to the trust in exchange for a promissory note. The promissory note typically is structured as an interest-only installment sale for a term of years, with interest at or above the applicable federal rate (AFR) and a "balloon" payment of principal at the end of the term.
   - The trust may want to post collateral to secure the note. If a life insurance policy is purchased by the trust, the policy may be used as collateral.



4. **After the assets are sold to the trust,** all appreciation and income stays in the trust for the benefit of the trust beneficiaries and outside of the grantor's taxable estate. Because the grantor is responsible for paying income taxes for the trust each year, the assets within the trust can accumulate and compound at a much faster rate.

5. **The trustee may use some of the seed gift and income** generated off of the asset sold to purchase a life insurance policy on the life of the grantor (or a joint life policy on grantor and grantor's spouse's lives). Trust income also can be used to pay the interest on the note each year and help towards repaying principal on the promissory note.

6. **At the grantor's death, trust assets will pass to the grantor's heirs free of estate, gift and GST taxes.** These assets include the life insurance death benefit, which should be received by the trust income-tax free. If the promissory note is still outstanding at the grantor's death, only the value of the note is includible in the grantor's estate; and the trustee can use the liquidity received from the insurance policy to repay this debt and infuse liquidity into the grantor's estate.

BENEFITS OF A SALE TO A GRANTOR TRUST

- **CREDITOR PROTECTION**
- **ESTATE EQUALIZATION:** Selling an asset to assist with the purchase of life insurance can help equalize a client's estate among heirs.
- **MULTI-GENERATIONAL PLANNING:** Allocating GST exemption to the seed gift amount enables the assets to grow within a generation-skipping trust free of GST tax over several generations.
- **ESTATE FREEZE:** For an asset that is expected to significantly appreciate in value and/or generate income, selling the asset to an IDGT is a highly effective way to remove the value of that asset from the grantor's estate and "freeze" it for estate tax valuation purposes.
- **GIFT AND INCOME TAX EFFICIENCY:** Other than the initial "seed" gift, a sale to a defective trust allows the grantor to transfer a valuable asset out of the estate with minimal gifting required. Also, no income tax is recognized on the sale of the asset or the interest payments received on the note.

Repaying the Promissory Note

Although there are several ways that the promissory note can be repaid, some of the most common "exit strategies" are highlighted below.

Consider these exit strategies in light of a client who has an asset worth $1,000,000, which produces annual income of 7% and is expected to appreciate in value.

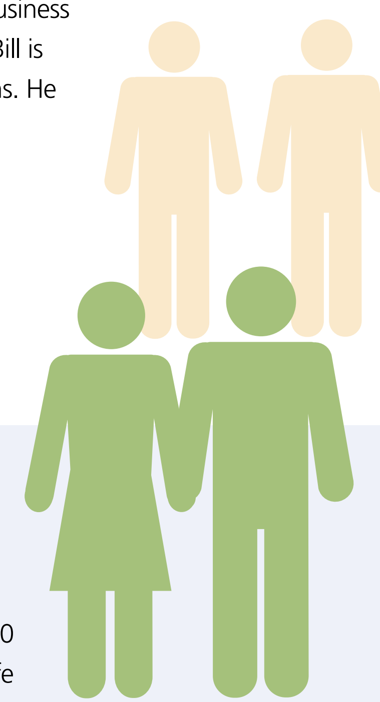
EXIT STRATEGY	EXAMPLE	WHEN TO USE
Arbitrage	If the client sells that asset to an IDGT in return for a 9-year promissory note, the trust can use the arbitrage between the 7% return ($70,000) and the interest owed to the lender (assume 1.5% mid-term AFR or $15,000/year) to pay the premium for those nine years. In this example, the "arbitrage" amount is $55,000/year. At the end of 9 years, the trust will sell back the asset/a portion of the asset equal to $1,000,000) to repay the note or may extend the repayment obligation by refinancing the note. The trust can fully repay the note in any given year as the asset itself does not need to be sold/liquidated in order to pay the insurance premium.	**Short- and Mid-Term loans where client is looking to have the asset returned in the future.**
Death Benefit Proceeds	The death benefit proceeds from the trust's life insurance policy can be used to repay the note to the client's estate. The client's estate now has the liquidity it needs to pay the costs of administering the estate and estate taxes without having to liquidate other assets in the estate.	**With true "estate freezes" where an asset is meant to stay outside of the estate and repayment will occur at death.**
Side Fund Using Annual Exclusion Gifts	The client may consider making annual exclusion gifts (if available) to the trust to help build up a side fund that can be used by the trust to help pay interest or principal back to the client/grantor.	**For a client who is selling an asset with an inconsistent investment return, where additional cash in trust would be helpful as a buffer.**

HYPOTHETICAL CASE STUDY

SITUATION: Bill Green, age 56, is a 45% owner of an LLC which holds and manages commercial real estate. Based on an appraisal recently obtained by the LLC, Bill's interest in the LLC is estimated to be about $3,500,000. Bill has a wife, Carrie, and two adult sons. Bill and Carrie have already used most of their lifetime/GST exemptions, and half of their net worth is comprised of the LLC and the income it generates.

Bill has begun thinking about his business succession plan. One of his sons (S1) will take over the business in the event of Bill's retirement, death or disability; the other son (S2) is not active in the company. Bill is concerned about providing for Carrie if he predeceases her and equalizing his estate among his sons. He also has three grandchildren that he would like to provide for, but is concerned about the GST tax.

Bill's advisor recommends that he sell his LLC interests to an IDGT to remove the asset and all appreciation from his estate and purchase life insurance inside the trust to provide for Carrie and S2.



HOW IT WORKS
Gift/Sale Transaction

Bill seeds the trust with a 10% seed gift equal to $350,000 using his remaining lifetime and GST exemption.

He then sells his interest in the LLC, appraised at $3,500,000, to the trust in exchange for a promissory note. The note is structured as an interest-only note (using long-term AFR of 2.25%) payable at Bill's death.

Using the income and growth generated by the LLC interests, the trustee makes annual loan interest payments to Bill of $78,750 and purchases a life insurance policy on Bill's life with a death benefit of $20,000,000 and an annual premium of $200,000.

At Bill's death, only the promissory note with a face amount of $3,500,000 will be included in his estate (assuming it has not been pre-paid); the trustee will use income and/or death benefit to repay the debt and the remaining trust assets will be held and distributed to Bill's wife and children as authorized by the trust agreement.

Take a look at the significant growth that occurs within the trust (and outside of Bill and Carrie's estate) by implementing this technique:

YEAR	OUTSTANDING LOAN	INTEREST DUE ON LOAN (@2.25%)	INSURANCE PREMIUM	LLC VALUE (EOY) (@2.5% GROWTH)	TRUST INCOME (EOY) (@7% ROR)	DEATH BENEFIT
1*	$3,500,000	$78,750	$200,000	$5,125,000	$371,250	**$20,000,000**
5	$3,500,000	$78,750	$200,000	$5,657,041	$601,224	**$20,000,000**
10	$3,500,000	$78,750	$200,000	$6,400,423	$1,204,879	**$20,000,000**
15	$3,500,000	$78,750	$200,000	$7,241,491	$2,320,288	**$20,000,000**
20	$3,500,000	$78,750	$200,000	$8,193,062	$4,188,772	**$20,000,000**
25	$3,500,000	$78,750	$200,000	$9,269,720	$7,153,443	**$20,000,000**
30	$3,500,000	$78,750	$200,000	$10,487,838	$11,700,777	**$20,000,000**

* In year 1, Trust also funded with $350,000 "seed" gift.

Assume that Bill dies in year 30 at age 86:

- At Bill's death, the trust will be worth approximately $40,000,000 between the value of the LLC interests, the trust income, and the insurance death benefit.
- At life expectancy the IRR on death benefit is 7.37% assuming a 35% tax bracket the pre tax equivalent is 11.34%.
- The $20,000,000 life insurance death benefit provides liquidity needed to equalize his estate among his sons and enhances the legacy left to his children.

PLANNING NOTE

If Bill had held onto the LLC interests rather than sell them to his trust, these business interests would be included in Bill's estate. Income and appreciation would be close to $20 million, which would equate to an $8 million estate tax liability. Instead, by engaging in this planning technique, all of this growth has been removed from Bill's estate and is transferred to his beneficiaries tax-free.

SUMMARY

A Sale to a Grantor Trust is a sophisticated planning technique that allows clients to achieve significant tax benefits while funding an irrevocable trust during lifetime. This type of trust can be particularly useful when clients own limited partnership interests, S-Corporation stock, or other income-producing assets that they are looking to transfer outside of the estate with minimal to no gifting required. Using this sale strategy, clients can transfer assets outside of their taxable estates and then use the trust income to fund a needed life insurance policy.

Commercial Premium Financing

IN A COMMERCIAL PREMIUM FINANCING ARRANGEMENT, the policy owner, often the trustee of a grantor's ILIT, borrows cash from a third-party commercial lender to fund a large life insurance policy premium.

Wealthy clients who choose to use third-party financing to pay premiums would often rather pay the premiums directly because:

- Their estate primarily is made up of illiquid assets that do not produce enough income to pay the premium.
- The cost of borrowing the money to pay premiums (i.e. the interest rate) is less than the return generated by assets held in the estate.
- Financing through a third-party lender may help to reduce their gift tax exposure because the loans made to the ILIT are not subject to gift tax.
- They expect a future liquidity event to exit the loan, but need short-term liquidity to pay premiums.

A LENDING TECHNIQUE THAT:

- **Relies on third-party lending**
- **Requires external collateral**
- **Has an interest rate determined by the lender**

PLANNING NOTES

TARGET CLIENT: The typical premium finance client is someone who has at least $5,000,000 of net worth and expects to incur premiums of $100,000 or more.

DISCLOSURE: Premium financing arrangements must be disclosed when purchasing a John Hancock life insurance policy.

PREMIUM RESTRICTIONS: Annual premium is restricted to 150% of the target premium. This restriction includes any Return of Premium (ROP) rider. Cases with premiums in excess of 150% of target premium require an exception.

MODIFIED ENDOWMENT CONTRACTS (MECS): MECs are not permitted with premium financing.

HOW IT WORKS

The grantor creates an ILIT

1

Under a typical commercial premium financing arrangement, the ILIT trustee submits a Premium Financing application to the lender to finance the premiums due on the policy concurrent with the submission of the life insurance application.

- The third-party commercial lender can be a premium finance lender or the client's own bank.

2

The lender establishes the terms of the note, including the loan interest rate and the note's payment schedule.

- Generally, premium loans are made annually and not in a lump sum.
- Although the ILIT is the "borrower," the proposed insured most often will need to provide a personal guaranty on the loan and submit to the third-party lender all financial information necessary for the lender to review and accept the loan application.
- The life insurance policy will be used as collateral for the loan, along with external collateral, if necessary.
- The lender will review the loan application and collateral requirements each year. Should the lender choose not to renew the loan for any reason, the ILIT will be responsible for paying the insurance premiums moving forward (likely via gifts from the grantor).

3

The ILIT is responsible for making loan interest payments directly to the lender each year.

- Unless the ILIT has cash available to make these payments, the grantor will need to gift the amount necessary each year to pay the interest.
- Loan interest is not deductible.

%

4

When the note is due to be repaid, the ILIT will be responsible for paying off this debt.

- If the life insurance policy values are not sufficient to pay off the loan when it becomes due, the grantor/insured may be called upon to pay off the debt on behalf of the ILIT.
- To help the ILIT exit a premium financing arrangement with the insurance intact, the grantor should incorporate a loan exit strategy, such as a GRAT/CLT, as part of the overall plan, or may gift assets to the ILIT to pay future loan interest or principal.

Mitigating Client Risk

Prior to accepting a premium finance offer, there are several risk factors of the arrangement clients **must** understand.

Some of these risk factors can be detrimental to a client's overall plan, so it is essential that they be addressed and understood at the outset of the engagement for all parties involved.

COLLATERAL REQUIREMENTS Most loans are structured as traditional recourse loans. This means that the loan is fully collateralized by the client/ILIT and a personal guaranty may be required. Although the policy's cash values can be used as collateral, often outside assets also will be needed, especially in the early years when cash value is low. This additional collateral may include securities, letters of credit and other cash or cash equivalents.

ZERO OUTLAY Caution should be taken on designs that promise clients a zero (or minimal) outlay to purchase life insurance. Despite what an illustration may indicate, most clients will need to contribute something to a premium financing design, especially given fluctuations in interest rates and policy performance. It is prudent that the agent, client, and client's legal team analyze all the underlying assumptions and are aware of the potential risks involved.

LIMITED PRODUCT OPTIONS Many premium financing designs will use universal and indexed universal life products. Variable universal life policies cannot be used in premium financing arrangements.

EXIT STRATEGY NEEDED The client will need to contemplate an exit strategy from the loan. For older insureds, this exit likely will come from death benefit proceeds paid at the insured's death. A return of premium (ROP) rider is often used in these cases so that the ILIT can repay the note and receive its desired net death benefit. For younger clients, it is often prudent to design the plan so that the loan is repaid before death using an exit strategy previously discussed (e.g. GRATs, CLTs, trust gifts, policy cash value, etc.).

REQUIRED GIFTING

Clients should keep in mind that the gift outlay will increase each year as additional loans are made and/or interest rates increase. Although the initial interest due may fall within the client's ability to make annual exclusion gifts, as the gift amount increases, the client may need to use lifetime exemption on these transfers or pay gift tax if exemption has been exhausted.

As you can see from the example, fluctuations in interest rates can substantially affect the amount of gifting that will be required from the client to make interest payments. If the grantor already has limited annual exclusions and/or lifetime exemption available, this additional gift may create an unwelcome gift tax liability.

Make sure premium finance designs show an increase in interest rates so that the clients are well-informed about this potential for gift tax exposure.

INTEREST RATE RISK The loan interest is established by the lender and usually involves a formula based on an index such as LIBOR (London Interbank Offered Rate) plus a spread. The spread is typically 175-350 basis points above the index. Loan interest can be paid in advance or arrears. A low-interest rate environment has made premium financing an attractive financing option. However, as interest rates change the costs associated with the financed premium could rise quickly.

HYPOTHETICAL CASE STUDY

How Rising Rates Can Affect Interest Payments

		ORIGINAL ASSUMED INTEREST AMOUNTS		ACTUAL INTEREST AMOUNTS	
YEAR	PREMIUM/LOAN	LOAN INTEREST RATE	LOAN INTEREST DUE	LOAN INTEREST RATE	LOAN INTEREST DUE
1	$100,00	2%	$2,000	2%	$2,000
2	$100,00	2%	$4,000	2%	$4,000
3	$100,00	2%	$6,000	2.50%	$7,000
4	$100,00	2%	$8,000	3.00%	$12,000
5	$100,00	2%	$10,000	3.50%	$15,000
6	$100,00	2%	$12,000	3.75%	$22,500
7	$100,00	2%	$14,000	4.50%	$31,500
8	$100,00	2%	$16,000	5.00%	$40,000
9	$100,00	2%	$18,000	5.50%	$49,500
10	$100,00	2%	$20,000	4.75%	$47,000
		Total	**$110,000**	**Total**	**$231,000**

SUMMARY

When designed properly, a Premium Financing arrangement may allow a client to minimize gift tax, retain control of invested assets, and transfer wealth to heirs with low impact on current cash flow and without requiring liquidation of taxable assets. However, it is important to keep in mind that financing premiums through Commercial Premium Financing is only one component of the high net worth insurance marketplace. In light of the many risks inherent to this technique, clients who start the conversation looking to engage in Premium Financing often find that other financing techniques can better suit their needs by offering similar benefits with less risk and costs. These techniques include gifting, Private Financing, Private Split Dollar, Sale of an Asset to a Defective Trust, and Dual Loan.

Dual Loan

THE "DUAL LOAN" APPROACH is a method of acquiring the cash needed for the grantor to enter into a private finance loan arrangement with his or her ILIT. Through a combination of an institutional loan to the grantor of an ILIT and a private finance loan, the trust can be efficiently funded without placing the grantor's personal wealth or assets in the trust.

This approach allows the grantor to take advantage of the benefits of commercial premium financing (e.g., use of outside liquidity) as well as the benefits of a private finance loan (e.g., fixed interest rates, managed investment risk) to create a flexible life insurance funding program that can minimize or eliminate gift taxes on large insurance premiums.

A LENDING TECHNIQUE THAT:

- **Relies on outside credit**
- **Combines Private Financing and Commercial Premium Financing**
- **Offers flexibility in plan design**
- **Relies on both AFR rates and lending interest rates**

When to use Dual Loan

This technique may work best for clients who:

- Need life insurance for estate liquidity or legacy purposes
- Do not want to make gifts or have exhausted annual exclusions and/or lifetime exemptions
- Lack sufficient liquidity for private financing arrangement;
- Lack income-producing assets that can be transferred in trust as part of a sale to a defective trust strategy
- Understand the benefits of leveraging the investment return on their assets with the use of outside liquidity

PLANNING NOTE

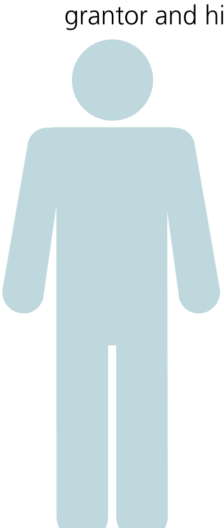
Affluent clients often can obtain very favorable interest rates from their bank, brokerage firm, etc. because of the existing relationship.

Alternatively, clients may have personal credit lines available to them, which would allow them immediate access to funds without negotiation as the terms of the credit line have already been established.

HOW IT WORKS

1

The grantor creates an ILIT, which will apply for insurance on his or her life; alternatively, a second-to-die policy could be purchased on the lives of the grantor and his or her spouse.



2

To fund the insurance premiums inside the trust, the grantor enters into a private financing loan arrangement whereby the grantor lends money to the trust in exchange for a promissory note charging sufficient interest. (See Private Financing for more information.)

3

Instead of using the grantor's own assets or liquidity, the client uses outside liquidity obtained from an institutional lender (e.g., bank, wire house, etc.) in order to enter into the private financing arrangement.

- The loan between the lender and the grantor generally will mirror the terms used in the private finance loan for both:
  - Length of time (term period)
  - Amount borrowed

> **For example:** if the grantor and the ILIT agree to a loan term of 9 years (using a mid-term AFR), the grantor will likely negotiate a 9 year term loan from his or her lending institution. Moreover, the principal borrowed from the institution is usually equal to the loan amount required under the private finance loan.

- The grantor must use personal assets such as real estate, business interests or securities as collateral to secure the debt to the lender. The life insurance policy, which is owned in the ILIT, *cannot* be used as collateral.

4

Once the loan has been approved and agreed to between the grantor and the lender, the lender advances cash to the grantor who in turn lends those funds to the ILIT.

5

Each year, the ILIT pays the grantor interest on the private finance loan and the grantor, in turn, must pay interest on the note to the lender.

- The interest rate on the loan made by the lender could be a fixed rate for the term of the loan or a variable rate based upon some index (e.g., prime rate or LIBOR).
- The interest income received by the grantor under the private finance loan in a sense "subsidizes" or offsets the institutional loan interest cost. For example, if the interest rate on the private finance loan is 1.5% and is 3.5% on the institutional loan, the grantor's "out-of-pocket" interest rate on the institutional loan is effectively 2%.

6

At the end of the loan term, the grantor repays the loan amount owed to the lender. The grantor can repay the loan from funds received by the ILIT as repayment on the private finance loan, or from the grantor's personal assets.

BENEFITS OF DUAL LOAN

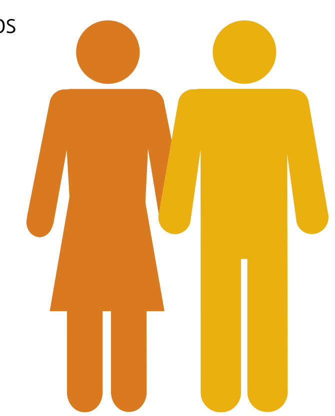
- Allows the grantor to enter into a private finance loan arrangement **without having to liquidate assets to lend to the ILIT**.
- Allows the grantor to negotiate the loan terms with their financial institution, which **generally leads to more favorable loan terms** than can be obtained through commercial premium finance companies (see Commercial Premium Financing section).
- Allows the ILIT **to take advantage of the lower AFR rates** available with private finance loans vs. commercial financing loans.
- The payments of interest on the institutional loan are NOT gifts (since the interest payments are made directly from the grantor to the lender) and therefore **not subject to gift taxes**.

HYPOTHETICAL CASE STUDY

SITUATION: Henry and Kate Cooper, both age 69, own a thriving family business. They need life insurance for liquidity purposes and have been approved for $8,200,000 of survivorship life insurance. To fund the premiums on this policy, which will be owned by their ILIT, their advisor introduces them to a private finance approach whereby they will lend $5,000,000 to their ILIT for 9 years. With the interest rate locked in at 1.5% (the mid-term AFR) and an assumed rate of return of 7% on the loaned assets, the ILIT trustee will pay 9 annual premium payments of $212,000 and make annual interest payments to Henry and Kate of $75,000. At the end of the 9 year loan term, the trustee will repay the loan balance.

Unfortunately, the Coopers do not have $5,000,000 of liquidity to lend to the trust and cannot transfer any of their income-producing assets at this time. They do, however, have strong banking relationships as well as personal lines of credit, and much of their property is unencumbered.

Using a dual loan approach, consider two different ways the Coopers can utilize their assets to place the life insurance in trust today, while they are both younger and healthy.



SCENARIO 1:
Mid-Term Dual Loan Design
100% Dual Loan Financing

Henry and Kate can access their existing personal line of credit or obtain a loan against the assets from the institutional lender for the entire $5,000,000 and use those proceeds to enter into the private finance arrangement with their ILIT. The terms of each loan are as follows:

	INSTITUTIONAL LOAN	PRIVATE FINANCE LOAN	NET INTEREST COST TO GRANTOR EACH YEAR
Term of Years	9 years	9 years	
Amount Borrowed	$5,000,000	$5,000,000	
Interest Rate	3.5% fixed	1.5% fixed	
Interest Paid Annually	**$175,000**	**$75,000**	**$100,000**

SCENARIO 2:
Mid-Term Dual Loan Design
60% Dual Loan Financing

Now assume that the clients have $2,000,000 in cash to commit to the $5,000,000 private finance arrangement; the remaining $3,000,000 will be borrowed under a Dual Loan arrangement. Because the amount of the institutional loan is lower than in the scenario above, the net interest cost is reduced to $30,000 per year.

	INSTITUTIONAL LOAN	PRIVATE FINANCE LOAN	NET INTEREST COST TO GRANTOR EACH YEAR
Term of Years	9 years	9 years	
Amount Borrowed	$3,000,000	$5,000,000	
Interest Rate	3.5% fixed	1.5% fixed	
Interest Paid Annually	**$105,000**	**$75,000**	**$30,000**

SUMMARY

The Dual Loan technique presents an alternative financing solution that addresses both gift tax concerns and liquidity issues that arise when funding a large life insurance policy inside an ILIT. It takes advantage of the certainties provided in private finance and blends them with the benefits of using outside liquidity. Utilizing a client's ability to negotiate favorable terms with his or her lending institution or using his or her existing personal lines of credit allows for maximum risk control and a flexible design to meet his or her estate and wealth transfer plans. Dual Loan can be used as a singular approach to life insurance funding or in concert with the many other established planning techniques by high net worth clients.

Private Split Dollar

THE PRIVATE SPLIT DOLLAR TECHNIQUE allows for the client to enter into an arrangement where the costs of a life insurance policy are shared or "split" between the client and his or her ILIT.

Fundamentally, this arrangement operates much like a loan to the ILIT: the grantor pays the life insurance premiums and possesses the right to be repaid at some point and time in the future. However, unlike more traditional loans, the repayment obligation requires that the ILIT repay the greater of cash value or premiums paid. Moreover, the "cost" to the ILIT in borrowing these premiums is measured by the cost of one year's worth of annual renewable term insurance, commonly referred to as the "economic benefit" costs.

A LENDING TECHNIQUE THAT:

- **Utilizes economic benefit instead of interest rates**
- **Requires repayment equal to the greater of premiums paid or cash value**
- **Minimizes gift tax exposure**

Economic Benefit Costs vs. Loan Interest

Despite the fact that we remain in a historically low interest rate environment, economic benefit costs typically are lower than the interest rates associated with annual premium loans, especially on survivorship policies or when the insured is younger than age 70.

Economic benefit costs are generally calculated by multiplying the portion of the death benefit receivable by the trust in a given year by the applicable economic benefit rate found in Table 2001 or the carrier's alternative term rate table.

When a survivorship policy is used, the economic benefit can be extremely low since the value of the death benefit is based on two lives.

For clients looking to pay premiums annually inside the ILIT, but want to reduce their gift tax exposure, a private split dollar arrangement under the economic benefit regime may be a helpful solution.

PLANNING NOTE

Pursuant to the Final Split Dollar Regulations, split dollar arrangements fall under one of two distinct regimes: the loan regime and the economic benefit regime.

This section focuses on split dollar arrangements governed by the economic benefit regime — in particular, non-equity collateral assignment split dollar. See the section on Private Financing for arrangements that would fall under the loan regime.

HOW IT WORKS

1

The grantor creates an ILIT, which will apply for insurance on his or her life; alternatively, a second-to-die policy could be purchased on the lives of the client and his or her spouse.

2

The trustee of the ILIT enters into a split dollar agreement with the grantor whereby the grantor will annually advance premiums on the life insurance policy owned inside the ILIT. As security for the premium advances, a collateral assignment will be placed on the policy, requiring payment of the greater of the policy's cash value or premiums paid at death or rollout.

3

Each year the grantor will be deemed to have made a gift to the ILIT equal to the "economic benefit" costs associated with the death benefit protection being provided to the ILIT. Alternatively, the ILIT can pay the economic benefit costs to the grantor to avoid a gift (if the ILIT is funded and has cash available).

- Because the economic benefit cost is the annual renewable term cost on the life of the actual insured, that cost increases incrementally each year as the insured gets older, unlike a fixed interest rate.
- Economic benefit costs increase over time as the insured ages. This increase becomes even more dramatic when second-to-die rates are used. Upon the death of one insured in a second-to-die scenario, the economic benefit calculation must switch to single life rates, resulting in much higher costs. In these situations, planners often employ a strategy called Switch Dollar. In a switch dollar plan, the plan is modified into a loan regime split dollar (private financing) when the economic benefit costs get too high.

4

At the grantor's death, the estate will be repaid using the death proceeds from the insurance policy. Alternatively, if the arrangement is terminated during the insured's lifetime, the ILIT will be responsible for repaying the debt or the grantor can choose to forgive the debt.

BENEFITS OF PRIVATE SPLIT DOLLAR

- **MINIMIZE GIFT TAXES:** If a client has no gifting available, a direct gift of the premium would cause a significant gift tax issue. A private split dollar arrangement limits the taxable gift amount to the annual economic benefit cost, which is significantly lower than the premium amount.
- **LOW ECONOMIC BENEFIT COSTS:** The economic benefit cost is often less than loan interest offered under private financing techniques, especially for second-to-die cases, making private split dollar an attractive alternative to private financing.
- **RETAIN CONTROL:** Rather than making an outright gift to the trust, resulting in a loss of control of the gifted funds, clients who use a private split dollar arrangement retain some control of their premium outlay. During life, the premium payor is due back the greater of premiums paid or policy cash value under the arrangement. Should a change in circumstances occur, the trust could repay the split dollar obligation either by surrendering the policy or by using other trust assets.
- **ESTATE FREEZE:** The amount due back to the payor or the estate is the greater or premiums paid or cash value. If the chosen policy does not provide a cash value greater than premiums paid, the amount due back to the estate is exactly the premium amounts paid, without growth. This "freezes" the amount of premium in the estate.

Repayment under a Private Split Dollar arrangement

Similar to other funding methods, there are various ways to repay the obligation. With a private split dollar arrangement, repayment can occur at death or while the insured is alive.

The most common repayment methods include:

POLICY DEATH BENEFIT

Due to the nature of the split dollar arrangement, the greater of policy cash value or premiums paid is due upon the death of the insured(s). The repayment of premium/cash can provide liquidity to the estate. The trustee can also use the death proceeds to lend to the estate or purchase assets out of the estate, providing even greater liquidity if needed.

RETURN OF PREMIUM

The Return of Premium rider can be used to repay the split dollar obligation to the estate, leaving increased liquidity to the trust.

WEALTH TRANSFER STRATEGIES

During the insured's life, the split dollar arrangement can be repaid through a number of wealth transfer strategies, including GRATs, CLATs, sales to defective trusts, or gifts.

HYPOTHETICAL CASE STUDY

Jim Smith, age 55, and his wife, Mary, age 50, have a total net worth of $40,000,000. They want to purchase insurance outside of their estate to provide liquidity to pay estate taxes and ultimately to benefit their two children. They have already used most of their lifetime exemptions and are looking for an efficient way to add $20,000,000 of life insurance to this trust for their liquidity needs.

The proposed second-to-die insurance policy with a $20,000,000 death benefit will cost approximately $108,000 a year for both of their lives, but they currently only have $56,000 of annual exclusion gifts ($28,000 x 2). To help minimize gift tax exposure, their advisor suggests using a Private Split Dollar (PSD) arrangement. Under the PSD agreement, the grantors will pay the premium each year and will make a gift of the "economic benefit" costs associated with the ILIT's interest in the death benefit. At the death of the second-to-die, the trust will be required to repay the greater of premiums paid or cash value. See Figure 1.

FIGURE 1

YEAR	INSURANCE PREMIUM	PSD REPAYMENT OBLIGATION	ECONOMIC BENEFIT COSTS	NET DEATH BENEFIT (AFTER LOAN REPAYMENT)
1	$108,200	$108,200	$195	**$19,892,400**
5	$108,200	$541,000	$441	**$19,459,000**
10	$108,200	$1,082,000	$1,223	**$18,918,000**
15	$108,200	$1,623,000	$3,667	**$18,377,000**
20	$108,200	$2,164,000	$10,317	**$17,836,000**
30	$108,200	$3,246,000	$64,498	**$16,754,000**

Jim and Mary could continue this arrangement until the death of the survivor, but the economic benefit costs will continue to rise, especially at the death of the first insured. For example, if we assume that Jim dies at age 85, the economic benefit costs would skyrocket from $64,498 in Year 30 to $186,815 in Year 31. Moreover, after Jim's death, Mary would need to continuing paying the premium each year along with gifting the economic benefit cost.

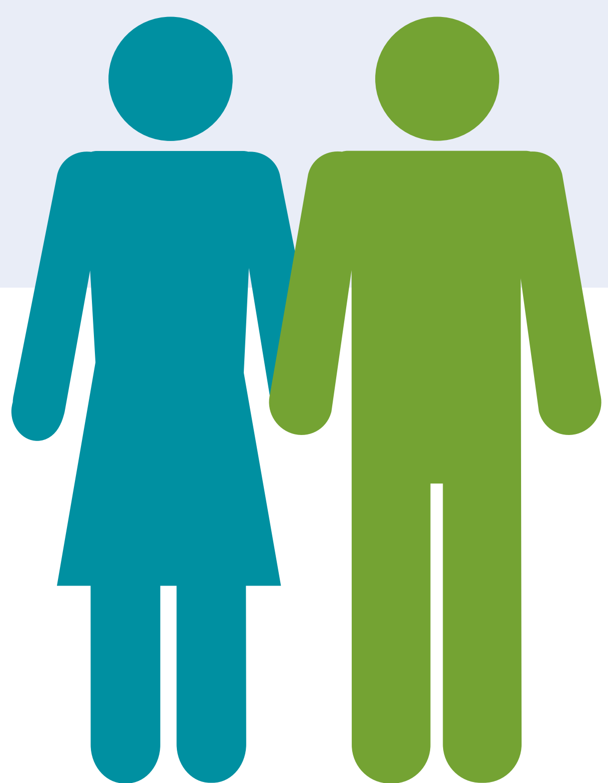
To avoid the substantial increase in economic benefit costs at the death of the first to die, Mary and Jim could utilize one of the following planning strategies:

SWITCH DOLLAR

At the death of the first insured, the split dollar arrangement would terminate and the trustee would execute a promissory note at the current AFR in an amount equal to the current repayment obligation. For example, if Jim dies in Year 30, the parties could agree to terminate the PSD and the ILIT trustee would provide a promissory note to Mary equal to the repayment obligation — e.g., $3,246,000 — repayable at Mary's death. If the long-term AFR in Year 30 is 4%, the interest due on the note each year would be $129,840, which is considerably less than what the economic benefit costs would be moving forward. If interest rates in Year 30 were much higher than 4%, then Mary may be better off sticking with the economic benefit for a period of time.

ANNUAL EXCLUSION SIDE FUND

Although Mary and Jim do not have enough annual exclusion gifts to cover each annual premium of $108,200 from the outset, they do have $56,000 of gifting available each year. Mary and Jim could consider making gifts of $56,000 to the trust each year (more as the annual exclusion amount gets indexed for inflation) in addition to paying the insurance premium. These annual exclusion gifts could be used by the ILIT trustee for two purposes: (1) paying the annual economic benefit costs to Mary and Jim and (2) as assets to invest to grow a side fund. For example, if the trustee invests the net $56,000 received each year, after paying economic benefit costs, at a 7% average return, in Year 21, the ILIT side fund will exceed the repayment obligation due under the split dollar agreement. Therefore, should Mary or Jim die prior to life expectancy, the trust will have assets from which it can either pay the much larger economic benefit costs or terminate the split dollar arrangement early and still retain the life insurance.



GRAT Exit Strategy

Instead of continuing the PSD for their joint lives, Mary and Jim decide to fund a 15 year term GRAT at the same time as they enter into the split dollar arrangement, and name the ILIT as the remainder beneficiary of the GRAT. Mary and Jim then transfer approximately $2,100,000 of securities into the GRAT assuming a 7520 rate of 1.8% and a rate of return of 7%. Mary and Jim will receive 15 annual annuity payments of approximately $162,000 — which is just shy of the amount needed to pay the annual premium of $108,200 and make the annual exclusion gifts of $56,000. At the end of the GRAT term, the remainder (projected to be approximately $1,750,000) will be distributed to the ILIT and the ILIT trustee will use this amount plus other trust assets to pay back Jim and Mary and terminate the split dollar plan.

RESULT USING GRAT:

Mary and Jim are repaid at the beginning of Year 16 (at the ages of 71/66) and the trust is expected to have enough assets to continue paying the $108,200 of premium each year without requiring additional gifting or loans from the grantors.

SUMMARY

Private Split Dollar is a powerful planning technique that allows a client to pay annual premiums on a policy owned in an ILIT without having to make large gifts that would exceed the client's lifetime exemption and incur gift taxes. This technique is often preferred over annual premium loans because the economic benefit costs are often lower when compared to current interest rates — especially for younger insureds or on a survivorship policy while both insureds are alive.

FOR MORE INFORMATION ON HOW TO CREATE A CUSTOM PRESENTATION FOR YOUR CLIENT, CONTACT ADVANCED MARKETS AND ASK ABOUT JH SOLUTIONS.

FOR MORE INFORMATION ABOUT FINANCING PREMIUMS, PLEASE CONTACT ADVANCED MARKETS 1-888-266-7498

OPTION 3 — CONSULTANTS
OPTION 4 — ATTORNEYS

John Hancock® INSURANCE

For Agent Use Only. This material may not be used with the public.

This material was not intended or written for use and cannot be used by any taxpayer for the purpose of avoiding any IRS penalty. It was written to support the marketing of the transactions or topics it addresses. Anyone interested in these transactions or topics should seek advice based on their particular circumstances from independent professional advisors.

1. Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.
2. Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59 1/2.
3. The internal rate of return on death benefit is equivalent to an interest rate at which an amount equal to the illustrated premiums could have been invested outside the policy to arrive at the net death benefit of the policy.
4. The IRS has determined that the transfer of assets between a grantor and his grantor trust will not be treated as a "sale for income tax purposes. See Revenue Ruling 85-13.

Insurance products are issued by: John Hancock Life Insurance Company (U.S.A.), Boston, MA 02210 (not licensed in New York) and John Hancock Life Insurance Company of New York, Valhalla, NY 10595.
MLINY090216037