ADVANCED PLANNING

Effective Strategies for Wealth Transfer

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What strategy to use and when?

The goals you have for your money while you're living and after you die are unique to you. These goals can come to fruition with the right strategy in place.

This guide will help you to identify approaches and will provide overviews of how they may work for your needs.

There are complex legal and tax implications associated with the strategies discussed, and you must consult your own tax and/or legal advisors to determine whether or not any strategy is appropriate for you.

YOUR FOCUS	YOUR CHALLENGE	YOUR STRATEGY OPTIONS
FAMILY	• Reduce the tax liability upon your death • Create a legacy for children and spouse • Provide liquidity upon death • Control distribution of wealth after death	• **Irrevocable Life Insurance Trust, page 8** • **Spousal Lifetime Access Trust using Survivorship Insurance, page 10** • **Credit Shelter Trust, page 12**
CHILDREN PRIOR TO CURRENT MARRIAGE	• Pass wealth to children from a prior marriage • Provide income and legacy for current spouse	• **Irrevocable Life Insurance Trust, page 8**
CHARITY AND FAMILY	• Provide for philanthropic interests without detracting from family legacy • Avoid capital gains tax on the sale of a highly appreciated asset • Create an income stream using a highly appreciated asset without triggering capital gains tax	• **Charitable Remainder Trust, page 20** • **Charitable Lead Trust, page 22**
GRANDCHILDREN AND BEYOND	• Pass a legacy on to multiple generations • Provide for grandchildren directly, bypassing wealthy children	• **Dynasty Trust, page 14**
INCOME-PRODUCING OR APPRECIATING ASSETS	• Reduce taxes upon transfer • Enhance lifetime gifts	• **Sale to an Intentionally Defective Irrevocable Grantor Trust, page 16** • **Private Split-Dollar Life Insurance with a Grantor Retained Annuity, page 18**
ANNUITIES, IRAS, AND OTHER TAX-DEFERRED ASSETS	• Avoid or reduce income and estate tax on transfer • Pass on a tax-deferred asset not needed for income in a tax-efficient manner • Increase the value of distributions to benefit heirs	• **Asset Protection+, page 6** • **IRA Distribution Strategy Using Life Insurance, page 24** • **IRA Distribution Strategy Using Life Insurance with Roth Conversion, page 26**
ACCESS TO ASSETS HELD IN TRUST	• Maintain access to assets held in an irrevocable trust • Access a life insurance policy held in a trust	• **Spousal Lifetime Access Trust using Survivorship Insurance, page 10**
WIDOW/WIDOWER	• Enhance assets currently in a Credit Shelter Trust for transfer to children	• **Credit Shelter Trust, page 12**

What Is a Wealth Transfer Strategy?

A wealth transfer strategy positions assets that may not be needed during one's lifetime for efficient transfer to the next generation. An effective strategy transfers wealth to heirs in a financially sound and, in some cases, tax-advantaged manner.

WHO NEEDS A WEALTH TRANSFER STRATEGY?

Almost everyone should be concerned with wealth transfer on some level. A common misconception is that wealth transfer strategies are only for the wealthy. While the wealthy may require sophisticated estate planning, a wealth transfer strategy is beneficial to everyone who has assets that will be transferred upon death. Depending on a person's age, family status, and asset mix, the wealth transfer process may be as simple as repositioning assets and establishing a will, or as complex as establishing trusts and involving other tax-reducing strategies.

Your real wealth...

- Values, Heritage, Traditions
- Wisdom, Experience, Ambition
- Children, Grandchildren, Great-Grandchildren
- Investments, Life Insurance, Business, Real Estate

Understanding Estate Taxes

A COMMON MISCONCEPTION

WEALTH TRANSFER STRATEGIES ARE ONLY FOR THE WEALTHY.

ESTATE TAXES

- The federal estate tax is levied upon the transfer of an estate at death.
- To eliminate the burden of the estate tax on the majority of estates, the federal government provides an *Applicable Exclusion Amount* ($11,580,000 for 2020, indexed annually for inflation).
- Estate taxes are assessed on all assets that exceed the exclusion threshold.
- Transfers made to either public or private charities are not subject to estate tax. Furthermore, most transfers made to a surviving spouse qualify for an unlimited marital deduction, which effectively delays the estate tax until the death of the surviving spouse.

The Tax Cuts and Jobs Act of 2017 (TCJA)

TCJA makes temporary changes to estate, gift, and generation-skipping transfer (GST) taxes.

Some estate related highlights are that it:

- Doubles the base estate, gift, and generation-skipping tax applicable exclusion amounts. This change expires on January 1, 2026.
- Changes the method of indexing the applicable exclusion amount for inflation. This change is permanent.
- Sets the maximum rate for estate, gift, and generation-skipping tax at 40%.
- Permanently maintains the portability provision that makes any applicable exclusion amount remaining unused after the death of the first spouse available to the surviving spouse. A timely filed federal estate tax return is required, even if no taxes are due, to qualify portability of the decedent's unused applicable exclusion amount.

Why Gifting Matters

To prevent people from avoiding the federal estate tax by giving away all their assets, the federal government imposes a **gift tax**.

THERE ARE TWO SIGNIFICANT EXCEPTIONS TO THE GIFT TAX

The unified estate and gift tax exclusions cause gifts made during life to offset the amount of exclusion available for transfers at death. However, there may still be a significant benefit in making gifts: Any appreciated value after the date of the gift may be excluded from the gift-giver's estate. For this reason, people typically plan to maximize the use of their exclusion by making gifts of property that is likely to appreciate significantly.

GIFT TAXES

To prevent people from avoiding the federal estate tax by giving away all their assets, the federal government imposes a gift tax. There are two significant exceptions to the gift tax.

- **GIFT TAX EXCLUSION**
  The annual gift tax exclusion allows every U.S. citizen or resident alien to give away $15,000* per person, per year. To be eligible for this annual exclusion, the gift must be of a present interest. Present interest gifts can be made with any type of transferable property, including cash or stock. For various reasons, many people choose to make present interest gifts in trust, rather than outright to the recipient. Special trust powers, known as "Crummey powers," may allow gifts made in trust to qualify for the annual exclusion.

- **APPLICABLE EXCLUSION AMOUNT**
  The second exception to the gift tax is the use of some of the Applicable Exclusion Amount during life. This allows every U.S. citizen or resident alien to transfer $11,580,000 (2020) during his or her lifetime without paying gift tax. This exclusion applies in addition to the annual gift tax exclusion. However, unlike the annual gift tax exclusion, any use of the Applicable Exclusion Amount during life reduces the Applicable Exclusion Amount available at death. Therefore, if a person makes a lifetime gift of $1 million, that person's Applicable Exclusion Amount at death is reduced by the same $1 million; therefore, it would be reduced to $10,580,000 (2020).

** The $15,000 figure is for 2020. Indexed annually for inflation.*

Using Life Insurance to Transfer Wealth

The **death benefit protection** offered by a life insurance policy can be a key component of a sound financial strategy.

THE BASICS

Life insurance is a unique financial instrument designed to provide liquidity at death. The tax characteristics of life insurance are consistent with its purpose. During the life of the insured, any cash value accumulation is on a tax-deferred basis so that there are generally no income tax consequences to the policyowner. When the insured dies, the life insurance proceeds are generally paid federal income tax-free to the policy beneficiary.

The death benefit protection offered by a life insurance policy can be a key component of a sound financial strategy. It is important to fully understand the terms and conditions of any financial product before purchasing it.

There are various types of life insurance policies available, including policies that insure the life of one person, and others insuring the lives of two people, usually spouses. The latter, called survivorship policies, are payable upon the death of the second insured person to die. Both types of policies can be important parts of a wealth transfer strategy.

YOU SHOULD KNOW

Life insurance policies contain fees and expenses, including cost of insurance, administrative fees and premium loads, surrender charges, and other charges or fees that will impact policy values.

PROFILE

- HAS A LARGE NON-QUALIFIED TAX-DEFERRED ASSET, QUALIFIED PLAN, OR TRADITIONAL IRA BALANCE NOT NEEDED DURING LIFETIME FOR SUPPORT IN RETIREMENT
- GENERALLY AGE 60+
- HAS A FINANCIAL STRATEGY DEVELOPED IN CONJUNCTION WITH A FINANCIAL PROFESSIONAL INDICATING CLIENT HAS SUFFICIENT INCOME FROM OTHER SOURCES TO MEET CURRENT AND FUTURE RETIREMENT INCOME NEEDS AND EXPENSES
- HAS A MINIMUM NET WORTH OF $1,000,000 AND SUFFICIENT LIQUID ASSETS TO SUPPORT THE STRATEGY
- WANTS TO REDUCE THE BURDEN OF INCOME AND/OR ESTATE TAXES FOR BENEFICIARIES
- WANTS TO POTENTIALLY ENHANCE HIS OR HER LEGACY TO BENEFICIARIES

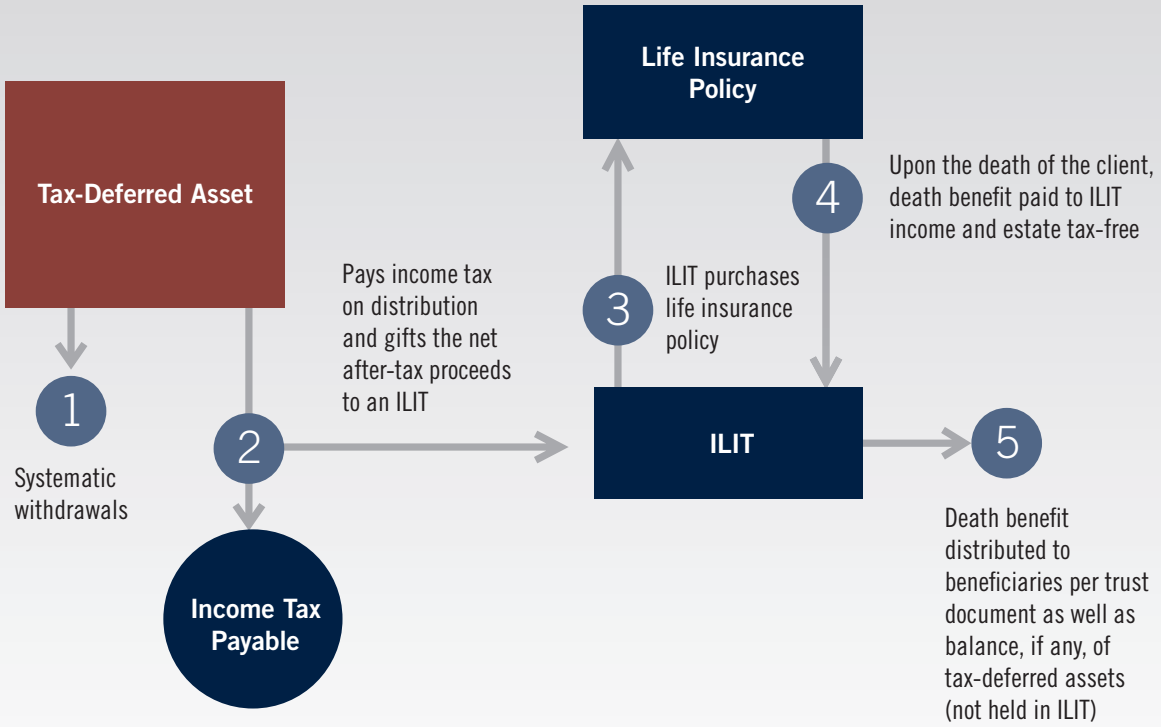
ASSET PROTECTION +

Asset Protection+ is the concept of repositioning assets during your lifetime to help protect them from taxes and other transfer costs at death. This strategy may be employed for any type of asset, but is most often used with tax-deferred assets, such as qualified plan balances, IRAs, and non-qualified, tax-deferred annuities that are not going to be utilized in life.

Often, it makes sense to reposition these assets because they could possibly be subject to both estate tax at death and income tax upon withdrawal. Life insurance is often the ideal financial instrument in which to reposition assets because the death benefits are generally received federal income tax-free. The policy may be held by a properly structured ILIT so that the proceeds may be received estate tax-free, too.

With the recent passage of the SECURE Act, Asset Protection+ may provide an alternate solution if you were planning on using an IRA or a retirement plan as a legacy asset. Under the SECURE Act, income taxes from qualified retirement distributions can no longer be deferred aka "stretched" over the lives of children and grandchildren. Assets must generally be distributed within 10 years.* As a result, larger account balances that are passed to heirs may force beneficiaries into the highest marginal income tax brackets, especially if accounts are deferred for 10 additional years.

*Except in cases of a spouse, a minor beneficiary, a chronically ill beneficiary, beneficiaries with special needs, or a beneficiary within 10 years of age of the owner of the IRA.



HOW IT WORKS

1. Systematic withdrawals are taken from a tax-deferred asset, such as a non-qualified annuity, IRA, or qualified plan.
2. Client pays applicable income tax, and gifts the net after-tax proceeds to an ILIT.
3. ILIT purchases life insurance on the person's life.
4. Upon the death of the individual, death benefit paid to ILIT income and estate tax-free.
5. Also, after death, proceeds are distributed to beneficiaries per trust document, along with the remaining balance of the tax-deferred assets.

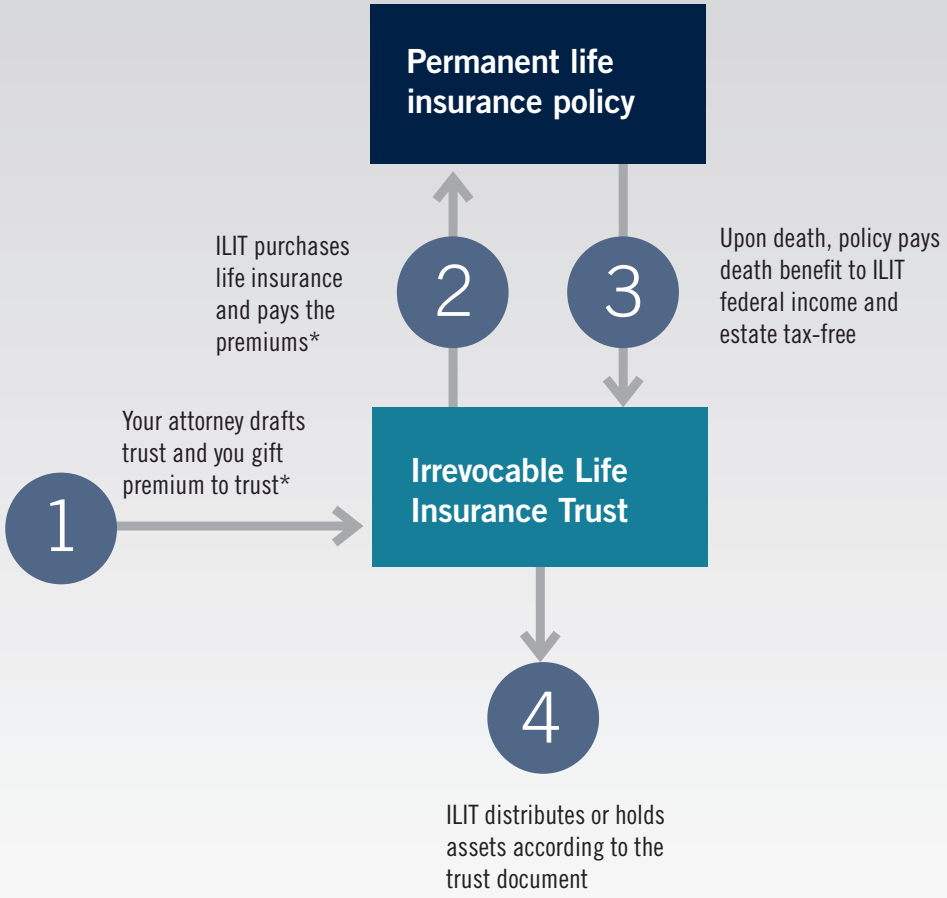
PROFILE

- INSURABLE ADULTS
- NEED FOR LIFE INSURANCE DEATH BENEFIT
- ANY INDIVIDUAL OR COUPLE THAT HAS A POTENTIAL ESTATE TAX LIABILITY
- ANY INDIVIDUAL OR COUPLE WITH LARGE AMOUNTS OF ILLIQUID ASSETS
- INDIVIDUALS LOOKING TO BENEFIT MULTIPLE PEOPLE WITH ONE POLICY

IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

An ILIT is designed to own life insurance and pass the proceeds on to the trust beneficiaries in a tax-efficient manner. To accomplish its purpose, the ILIT must be both the owner and beneficiary of the policy. The life insurance premiums are typically paid with gifts made to the trust from the creators of the trust. Gifts made to an ILIT may qualify for the annual gift tax exclusion so that there are no adverse gift tax consequences associated with the gifts to the trust.

Upon the death of the insured, the trust will collect the life insurance death benefit proceeds and distribute or hold them according to the trust document. The life insurance proceeds are generally received income tax-free by the trust, and, assuming the trust is properly drafted and administered, the life insurance proceeds will also be outside the estate of the insured.



HOW IT WORKS

1. Your attorney drafts the ILIT, according to your purpose.
2. The trust purchases life insurance on your life with dollars you gift to the trust.
3. Upon death, the life insurance death benefit will be paid federal income and estate tax-free to the trust.
4. According to the trust document, the ILIT distributes, holds, or purchases assets from the insured-grantor's estate to provide liquidity.

** There may be federal gift tax consequences associated with the funding of an Irrevocable Life Insurance Trust.*

PROFILE

- COUPLES WHO ARE INSURABLE AND NEED SECOND-TO-DIE LIFE INSURANCE PROTECTION
- UNDERSTAND THE BENEFITS OF ADDING LIFE INSURANCE TO A WEALTH TRANSFER PLAN
- WANT ONE SPOUSE TO HAVE SOME ABILITY TO INDIRECTLY ACCESS CASH VALUES OF THE LIFE INSURANCE, BUT ALSO WANT THE PROCEEDS EXCLUDED FROM THEIR ESTATES

SPOUSAL LIFETIME ACCESS TRUST, USING SURVIVORSHIP INSURANCE

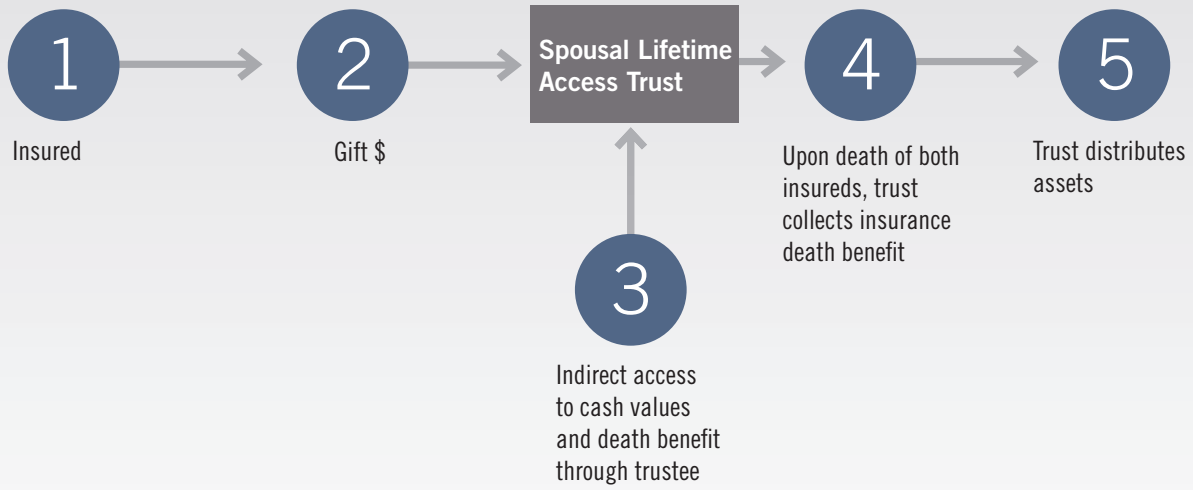
A Spousal Lifetime Access Trust (SLAT) using survivorship insurance is a specially drafted ILIT for couples. It is designed to keep second-to-die life insurance proceeds outside the estate of both insureds and still allow indirect access to the account value of the life insurance policy to one partner through an independent, third-party trustee.

Under this strategy one insured, the grantor, makes gifts to the trust. The trustee uses the gifts to purchase a second-to-die life insurance policy. The second insured, or non-grantor, along with any children, are beneficiaries of the trust. Under the terms of the trust document, the trustee may make discretionary distributions of the trust income and/or principal to any of the trust beneficiaries, including the non-grantor spouse.*

When properly structured, a Spousal Lifetime Access Trust (SLAT) using survivorship insurance allows for people to take advantage of a federal estate tax-free death benefit while allowing one insured indirect access through the trustee to the life insurance cash values through policy loans and withdrawals. Both loans and withdrawals from a permanent life insurance policy may be subject to penalties and fees and, along with any accrued loan interest, will reduce the policy's Account Value and Death Benefit. In addition, there may be tax consequences.

Using the annual gift tax exclusion amount, the grantor spouse may gift up to $15,000 annually per beneficiary of the trust (excluding the non-grantor spouse beneficiary) without federal gift tax consequences. The non-grantor spouse must not make any gifts to the trust because any gifts by the non-grantor could result in estate tax inclusion. Even though the non-grantor spouse cannot make any direct or indirect gifts to the trust, he or she may still be able to consent to gift splitting depending on the exact terms of the trust, allowing the grantor spouse to double his or her gifting amount to $30,000 for 2020. You should consider how future life insurance premiums would be paid if the grantor spouse dies first, since the non-grantor spouse cannot make gifts to the trust.

** A gift tax return will need to be filed by both spouses if they elect to split gifts in excess of the annual exclusion amount. A question remains whether or not the mere filing of a gift tax return makes the non-grantor spouse a grantor. There may be estate tax consequences if the filing of a gift tax return does make the non-grantor spouse a grantor.*



HOW IT WORKS

1. One spouse, the grantor spouse, makes gifts of cash to an ILIT drafted as a Spousal Lifetime Access Trust (SLAT).
2. The third-party trustee of the SLAT purchases a second-to-die life insurance policy with the gifted cash.
3. During the lifetime of the insureds, the trustee may make discretionary distributions of the policy's cash value through loans and withdrawals to either the non-grantor spouse and/or the children.
4. Upon the death of both insureds, the trust collects the life insurance death benefit proceeds federal income and estate tax-free.
5. Trustee distributes assets per trust document.

PROFILE

- WIDOW OR WIDOWER AGE 85 OR YOUNGER WHO IS A BENEFICIARY OF A CREDIT SHELTER TRUST
- WANTS TO PASS AS MUCH WEALTH AS POSSIBLE TO TRUST BENEFICIARIES
- SURVIVING SPOUSE DOES NOT NEED THE INCOME BEING DISTRIBUTED FROM THE CREDIT SHELTER TRUST
- WOULD LIKE TO RECEIVE A "STEP-UP" IN COST BASIS ON THE LIFE INSURANCE DEATH PROCEEDS WITHIN THE TRUST AT HIS OR HER DEATH

CREDIT SHELTER TRUSTS WITH LIFE INSURANCE

This strategy is accomplished by transferring into a trust an amount equal to the Applicable Exclusion Amount upon the death of the first spouse. The Credit Shelter Trust—also called a B-Trust or a Family Trust—usually provides that the surviving spouse shall receive all the income from the trust at least annually and the children will receive the principal of the trust upon the death of the surviving spouse.

As a result of this common estate technique, many wealthy widows or widowers end up the beneficiary of a Credit Shelter Trust. In many cases, the trust was set up for the purposes of reducing the estate tax exposure of the combined estate and for the spouse who dies first to designate who and how the property will be distributed. The surviving spouse may receive income payments from the trust but may not actually need those income payments to support his or her standard of living.

If the surviving spouse does not need the income from the Credit Shelter Trust and would like to potentially help increase the amount of wealth passing to the other trust beneficiaries, the surviving spouse can allow the trustee to purchase life insurance on his or her life within the trust. This strategy may provide a number of potential benefits, including:

- "Step-up" cost basis on the life insurance death proceeds because of the tax-free receipt of the life insurance death benefit by the trust.
- Any tax-deferred accumulation of policy values should not generate any income, or income tax, for the surviving spouse.

HOW IT WORKS

1. Surviving spouse has attorney review trust document to determine if trustee can purchase life insurance within the credit shelter trust.*
2. Surviving spouse resigns from trustee position (if applicable).
3. Trustee purchases life insurance on life of surviving spouse.
4. Upon the death of surviving spouse, the trust receives the insurance death benefit federally income and estate tax-free.
5. Trustee distributes assets per trust document.

** There may be federal gift tax consequences associated with the funding of an Irrevocable Life Insurance Trust.*

PROFILE

- WEALTHY FAMILIES WHERE WEALTH WILL ULTIMATELY BE PASSED TO MULTIPLE GENERATIONS
- WANT TO REMOVE LARGE AMOUNTS OF WEALTH FROM THE ESTATE TAX SYSTEM
- WANT TO CREATE A "FAMILY DYNASTY"
- WANT TO PROVIDE INCOME FOR THE NEXT GENERATIONS, INCLUDING CHILDREN AND GRANDCHILDREN
- INTERESTED IN CREDITOR PROTECTION (CREDITOR PROTECTION IS FOR THE TRUST BENEFICIARIES BECAUSE THEY DO NOT GENERALLY HAVE OUTRIGHT OWNERSHIP.)

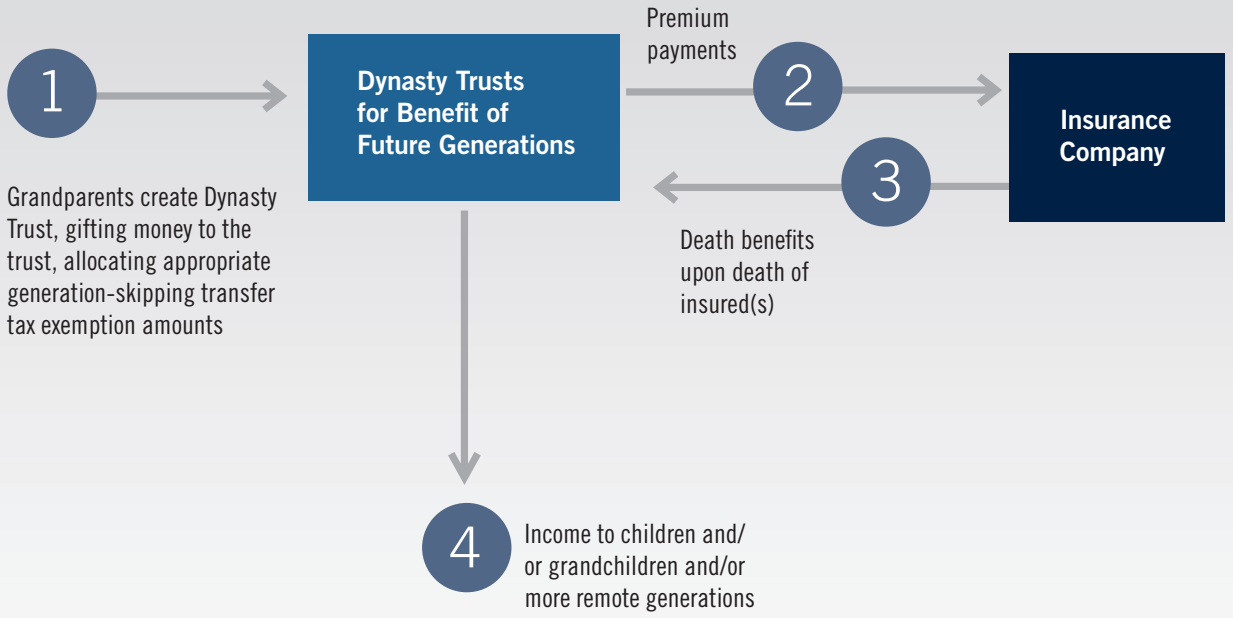
DYNASTY TRUST

The generation-skipping transfer tax is assessed on transfers of property to a generation two or more removed from the transferor. Its purpose is to prevent people from avoiding the estate tax at any particular generational level by simply skipping over that generation in favor of more remote ones. Like the estate and gift tax, individuals are also allowed an exemption from the generation-skipping tax. The exemption amount is currently equal to the estate tax exclusion amount. The client profile would be an individual or couple usually with a net worth of $10 – $20 million or more and family oriented.

A Dynasty Trust is an irrevocable trust designed to last for many generations. The key to an effective Dynasty Trust is to increase the use of the generation-skipping transfer (GST) tax exemptions while still complying with the estate and gift tax rules. Life insurance is often a preferred funding vehicle for a Dynasty Trust because:

- It is designed to help increase wealth transfer
- It provides for tax-deferred accumulation
- The death benefit provides an effective "step-up" in basis upon the death of the insured(s)

The effective step-up occurs because the death benefits are paid federally income tax-free to the trust. By funding a Dynasty Trust with life insurance, you can potentially increase the amount of wealth transferred to future generations, estate and generation-skipping transfer tax-free.



HOW IT WORKS

1. Grandparents create a Dynasty Trust; they gift money to the trust and allocate their appropriate generation-skipping tax exemptions to the gifts.*
2. Dynasty Trust purchases life insurance on the lives of the grandparents.
3. Death benefits are paid to trust upon deaths of grandparents.
4. Trust makes distributions of income and principal to children and/or grandchildren and/or more remote generations for as long as possible under applicable state law.

THE RULE AGAINST PERPETUITIES

Whenever discussing the possibility of a trust lasting into perpetuity (forever), the Rule Against Perpetuities must be discussed. The Rule Against Perpetuities is a common law rule that provides that no interest in property is valid unless the interest vests no later than 21 years after the life or lives in being when the interest is created. This rule is very complex and a full explanation is beyond the scope of this brochure. What you need to remember is that there are state laws that limit the amount of time that a trust can last, some states have increased the length of vesting, and some have abolished or repealed the rule.

** There may be federal gift tax consequences associated with the funding of a Dynasty Trust.*

PROFILE

- HIGH NET WORTH
- LOOKING TO ENHANCE VALUE OF WEALTH
- HAS INCOME-PRODUCING ASSETS
- EXPECTS ASSETS TO APPRECIATE SIGNIFICANTLY

SALE TO INTENTIONALLY DEFECTIVE IRREVOCABLE GRANTOR TRUST

In some cases, a single-asset estate strategy is not appropriate. People with very high net worth often require more sophisticated estate planning and wealth transfer techniques. One popular strategy for high-net-worth people is to sell assets to an Intentionally Defective Irrevocable Grantor Trust (IDIGT) in order to remove as much appreciation as possible from their estates.

Simply stated, an IDIGT is one that is ignored for income tax purposes but valid for estate and gift tax purposes. When properly structured, transactions, such as sales, between the trust and the grantor will be ignored for income tax purposes. With the help of an attorney, you can create an IDIGT and seed the trust with an initial contribution (typically about 10% of the value of the property that will subsequently be sold to the trust).

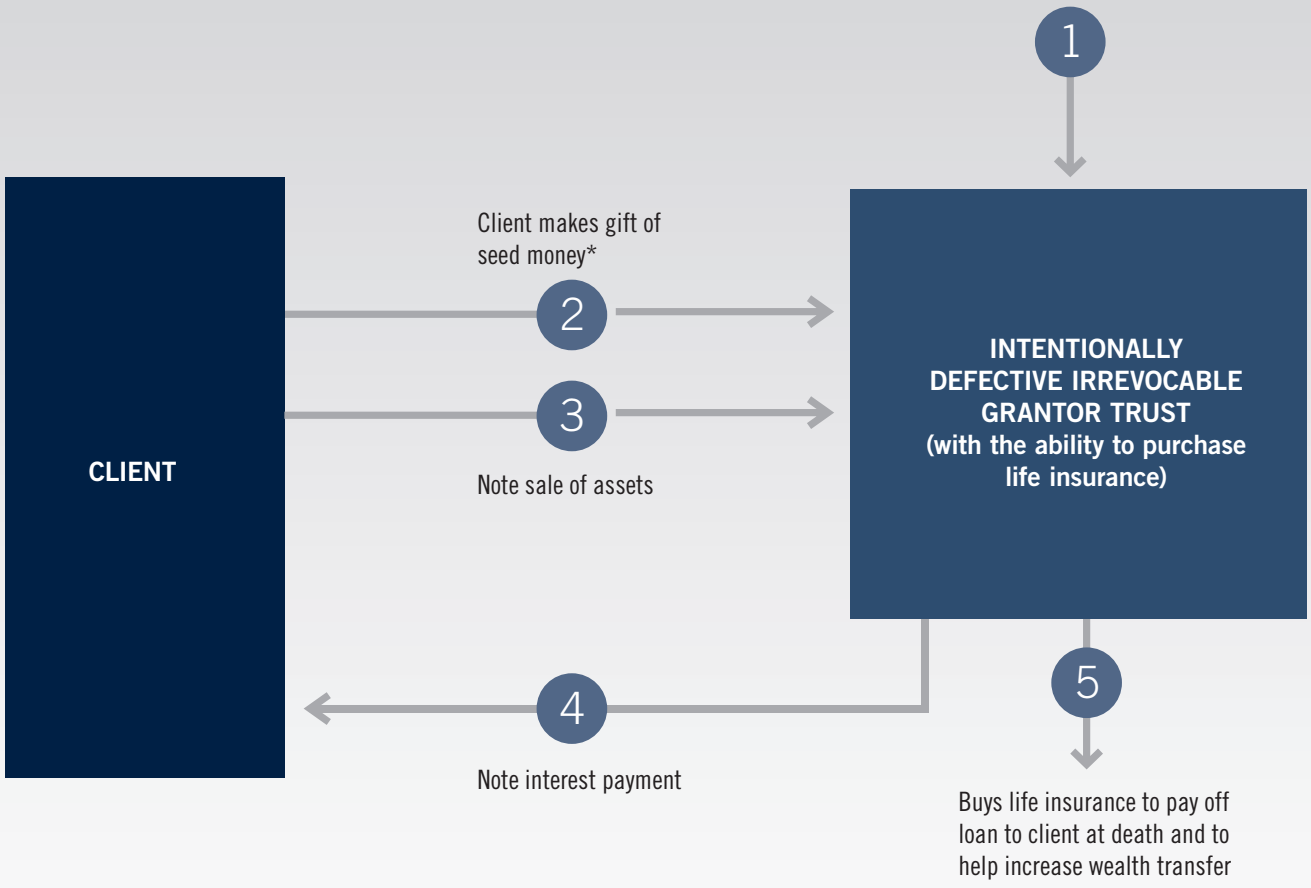
After the trust is seeded, you may sell assets (often income-producing discounted assets based on a qualified appraisal, such as limited partnership interests or non-voting S Corp stock) to the trust for an interest-only note with a balloon payment after a specified duration. Because the trust is ignored for income tax purposes, the seller does not recognize any gains on the sale. The trustee then uses the income from the assets to pay the interest on the note, which is typically set at the appropriate applicable federal rate for the term of the loan. All income in excess of the amount payable under the note remains an asset of the trust and outside the estate of the insured. All income earned by the assets of the trust remains taxable to the grantor.

The note sale can be a powerful technique for gift tax leveraging because the only taxable gift is the seed money. Since the gift of the seed money is typically less than the client's available Applicable Exclusion Amount, it is an excellent way to leverage this exclusion.

Typically, life insurance is purchased with some of the excess income retained by the trust. Life insurance provides a means of making the balloon payment on the note if the insured/seller dies before the note is fully repaid by the trust. Also, the life insurance can help increase the amount of wealth transfer possible by providing income tax-deferred accumulation and a federal income tax-free death benefit.

The gift and note sale strategy is an advanced tax planning technique that may not be appropriate for all persons and should only be entered into with the advice of competent legal counsel. There are certain ambiguities with regard to the income tax treatment of a grantor trust upon the death of the grantor. However, life insurance proceeds are generally received income tax-free upon the death of the insured under Internal Revenue Code section 101(a).

Proper valuation of the property to be sold to the trust is critical because if the valuation is ultimately determined to be wrong, part of the sale transaction may be recharacterized as a gift.



HOW IT WORKS

1. You create an ILIT that is drafted as an Intentionally Defective Irrevocable Grantor Trust (IDIGT).
2. You make an initial gift of seed money to the trust (typically about 10% of the anticipated sale).*
3. You sell appropriate appreciating assets to the trust for a note.
4. Trust uses income from the assets it purchased to pay the interest due on the note to you.
5. Excess income is used by the trustee to purchase a life insurance policy for wealth transfer and to ensure the trust has enough assets to pay off the note in the event of a premature death.

* *There may be federal gift tax consequences associated with the funding of an IDIGT.*

PROFILE

- HIGH NET WORTH
- APPROPRIATE ASSET PORTFOLIO
  - ASSETS THAT CAN BE DISCOUNTED OR TRANSFERRED TO AN ASSET AND DISCOUNTED (SUCH AS A FAMILY LIMITED PARTNERSHIP)
  - HIGHLY APPRECIATING ASSETS
- NEED FOR INSURANCE POLICY WITH PREMIUMS IN EXCESS OF AVAILABLE GIFTING EXCLUSIONS

PRIVATE SPLIT-DOLLAR LIFE INSURANCE WITH A GRANTOR RETAINED ANNUITY TRUST

Combining the benefits of a private split-dollar life insurance arrangement with a Grantor Retained Annuity Trust (GRAT) can help increase wealth transfer.

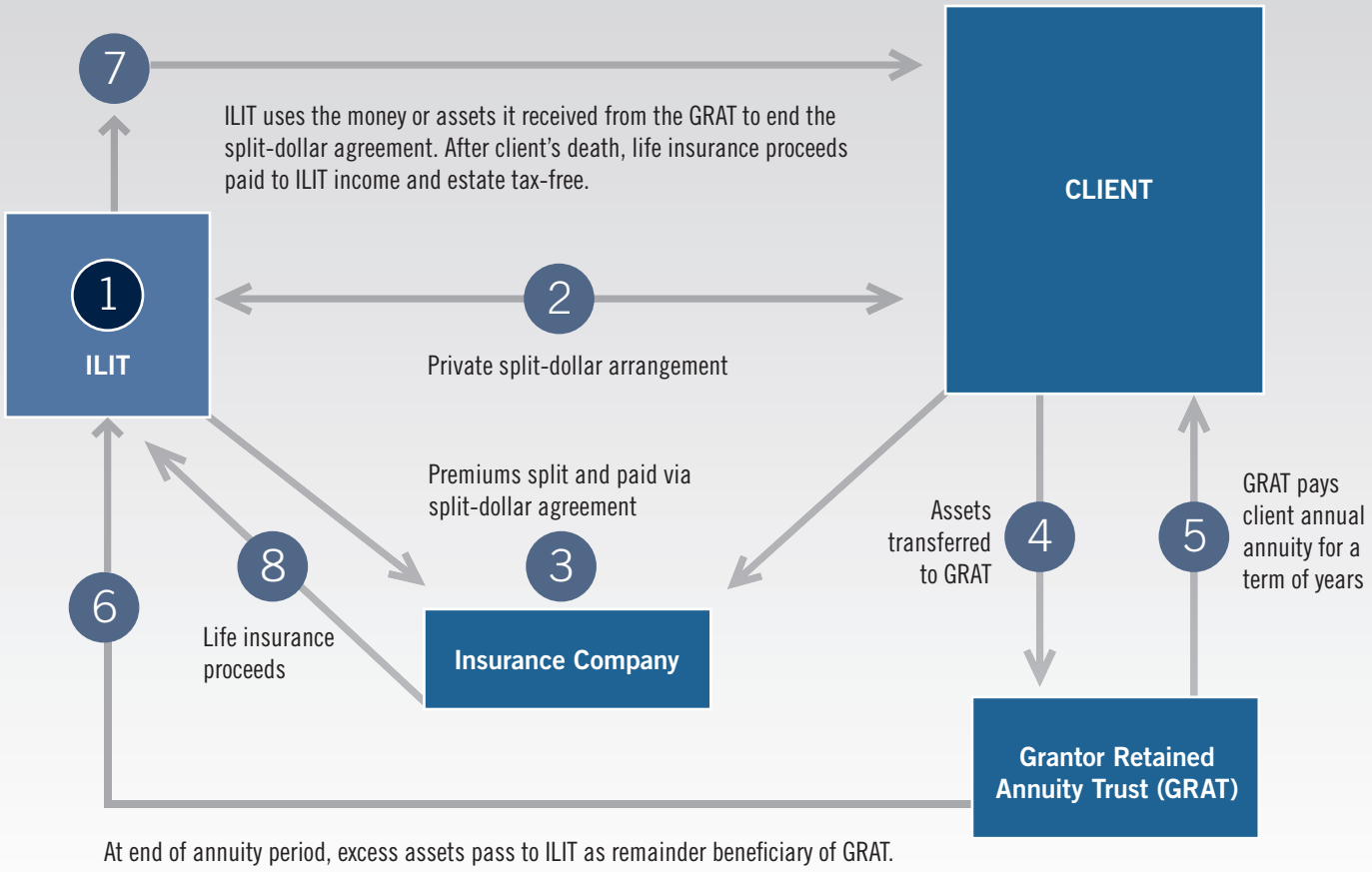
The Private Split-Dollar Arrangement

A split-dollar life insurance ownership arrangement allows two parties to share the costs and benefits of a cash value life insurance policy. The costs and benefits are generally split so that one party, typically an insured (or an uninsured spouse), owns the policy cash value and a portion of the death benefit equal to the greater of cash value or premiums paid. The other party, typically an ILIT, is entitled to the balance of the death benefit. The party with an interest in the policy cash value pays the majority of the premium and the other party, typically the ILIT, will pay only that portion of the premium that represents the value of one year's worth of term insurance.

This premium allocation typically allows for significant gift tax leverage because the only part of the premium that the ILIT must pay is the one-year term cost, which is usually only a fraction of the actual premium. The gift tax leverage decreases as the insured gets older and the cost of the one-year term insurance increases. Ideally, the split-dollar arrangement will be terminated before the term costs become prohibitive and after all the premiums have been paid. Termination may result in income tax and/or gift tax. One way to terminate a split-dollar arrangement is to transfer additional funds to the Irrevocable Life Insurance Trust so that it can repay the other party its interest in the policy without impairing the life insurance policy. One of the most popular methods to achieve this is with a zeroed-out GRAT.

How GRATs Work

In a GRAT, the grantor transfers property to the trust and retains an annuity interest in the transferred property for a number of years. When the term ends, the balance of the trust property is transferred to the remainder beneficiary of the GRAT. A GRAT can allow for significant gift tax leverage because, for gift tax purposes, the value of the gift to a GRAT is determined by subtracting the present value of the annuity interest from the total amount transferred to the trust. Ultimate gift tax leverage is accomplished by creating a zeroed-out GRAT. In this case, the present value of the annuity interest is equal to the value of the property contributed. A contribution to a zeroed-out GRAT does not produce a taxable gift, but can result in a significant amount of wealth being transferred from one party to another if the assets in the GRAT appreciate at a rate in excess of the annuity rate.[1] Naming an ILIT subject to a split-dollar arrangement as the beneficiary of the GRAT may provide the ILIT with the funds necessary to terminate the split-dollar arrangement in the future.



HOW IT WORKS

1. Individual creates an Irrevocable Life Insurance Trust (ILIT) for the benefit of his or her family.
2. Trustee enters into a private split-dollar agreement with the individual.
3. Life insurance premiums are split and paid via the private split-dollar agreement.
4. Client then creates a Grantor Retained Annuity Trust (GRAT) and transfers assets into it.[2]
5. Under the terms of the GRAT, the client receives a qualified annuity interest (typically a fixed payment) for a term of years.
6. Upon the expiration of the term of years any assets remaining in the GRAT pass to the ILIT as the remainder beneficiary of the GRAT.
7. The ILIT uses the assets it receives from the GRAT to exit the split-dollar agreement.
8. The life insurance proceeds are payable to the ILIT at death, and are income and estate tax-free.

[1] *All or a portion of the property in the GRAT will be includable in the estate of the grantor if the grantor dies prior to the expiration of the GRAT.*

[2] *It is important when transferring property to a GRAT that the transferred property is valued correctly. Inaccurate valuations can lead to adverse gift-tax consequences.*

PROFILE

- GENERALLY AGE 50+, INSURABLE
- CHARITABLY INCLINED
- HAS APPRECIATED CAPITAL GAIN ASSETS
- IN NEED OF AN INCOME TAX DEDUCTION
- LOOKING FOR ADDITIONAL INCOME

CHARITABLE REMAINDER TRUST

A Charitable Remainder Trust (CRT) is a split-interest trust with both a charitable and a non-charitable beneficiary. Through the use of a CRT, people can benefit themselves and their favorite charity. The individual benefits are typically through an income tax deduction, the size of which depends on that portion of the trust that will benefit the charity and whether an income stream is provided for either a set number of years (not to exceed 20) or for the rest of the person's life. At the end of the specified term, or when the client dies, the remaining balance in the CRT passes to the charity.

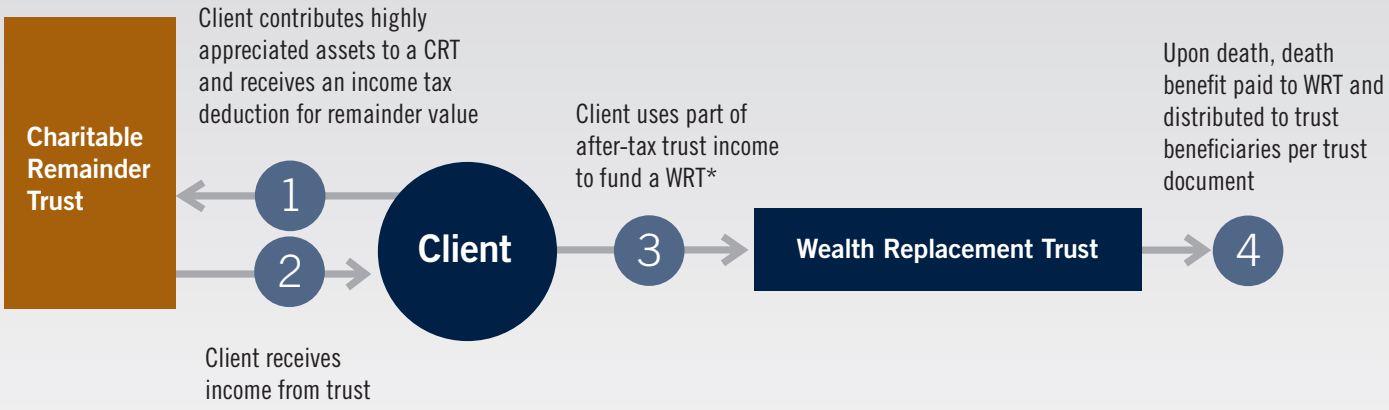
In most instances, people choose to give highly appreciated assets to CRTs since tax laws allow for them to receive an income tax deduction on the property that is contributed, based on the full, appreciated value, even though the appreciation has not yet been recognized. Once the asset has been contributed to the CRT, the trustee will typically sell it. Since the CRT is a tax-exempt entity, no income tax will be due upon the sale. In some cases, the tax-free nature of the sale helps increase the income stream because, depending on how the trust is designed, the income stream may be based on a percentage of the trust assets.

Because the remaining balance of the CRT will eventually pass to a charity and not heirs, many choose to purchase life insurance inside a Wealth Replacement Trust (WRT) to replace the value of the assets given to the charity at death. A WRT is an irrevocable trust designed to own a life insurance policy outside the estate of the insured(s). By combining a CRT with life insurance in a WRT, clients may be able to leave a significant amount to their favorite charity and still transfer wealth to their heirs.

With the recent passage of the SECURE Act, a CRT may provide an alternate solution if you were planning to leave an IRA or other retirement asset to heirs. Under the SECURE Act, IRA and retirement assets can no longer be stretched over the lives of non-spouse beneficiaries, and instead must be fully distributed within 10 years.* By using a CRT strategy, an individual would name a CRT the beneficiary of his or her IRA or retirement plan and children and/or grandchildren as lifetime income beneficiaries of the trust.

Note: Small grandchildren, under the age of 27, are problematic with today's low interest rates, based on a code section 7520 rate of 2.0%. Problematic means the CRUT will "fail" as a charitable trust. The funding of the CRUT does not occur until the death of the participant and spouse, so young grandchildren today may all be older than age 27 when the trust is funded. Also, higher interest rates will have an impact on this limitation.

*Except in cases of a spouse, a minor beneficiary, a chronically ill beneficiary, beneficiaries with special needs, or a beneficiary within 10 years of age of the owner of the IRA.



HOW IT WORKS

1. You irrevocably gift assets (usually highly appreciated) to a charitable remainder trust. The donor is entitled to an immediate federal income tax deduction for the present value of the remainder gift. (Any unused federal income tax cannot be deducted in the current year, but may be carried over for a maximum of five additional years.)
2. The trustee typically sells the assets and reinvests them. Since the CRT is a tax-exempt trust, no taxes are due upon the sale. The trust then pays the income beneficiary (usually the donor) a fixed payment or fixed percentage of trust assets for a life or a term of years (not to exceed 20).
3. The income beneficiary uses part of the after-tax income stream to make premium gifts to a wealth replacement trust (WRT). The WRT purchases life insurance designed to replace the value of the assets for the heirs.*
4. Upon death, the life insurance death benefit is paid to the WRT, which subsequently makes distributions to beneficiaries per the trust document. At the same time, the charity receives the balance remaining in the CRT.

** There may be federal gift tax consequences associated with the funding of a Wealth Replacement Trust.*

PROFILE

- AGE 65+
- CHARITABLY INCLINED
- SIGNIFICANT ESTATE TAX EXPOSURE
- WOULD LIKE TO ENHANCE VALUE OF WEALTH THAT PASSES TO NEXT GENERATION

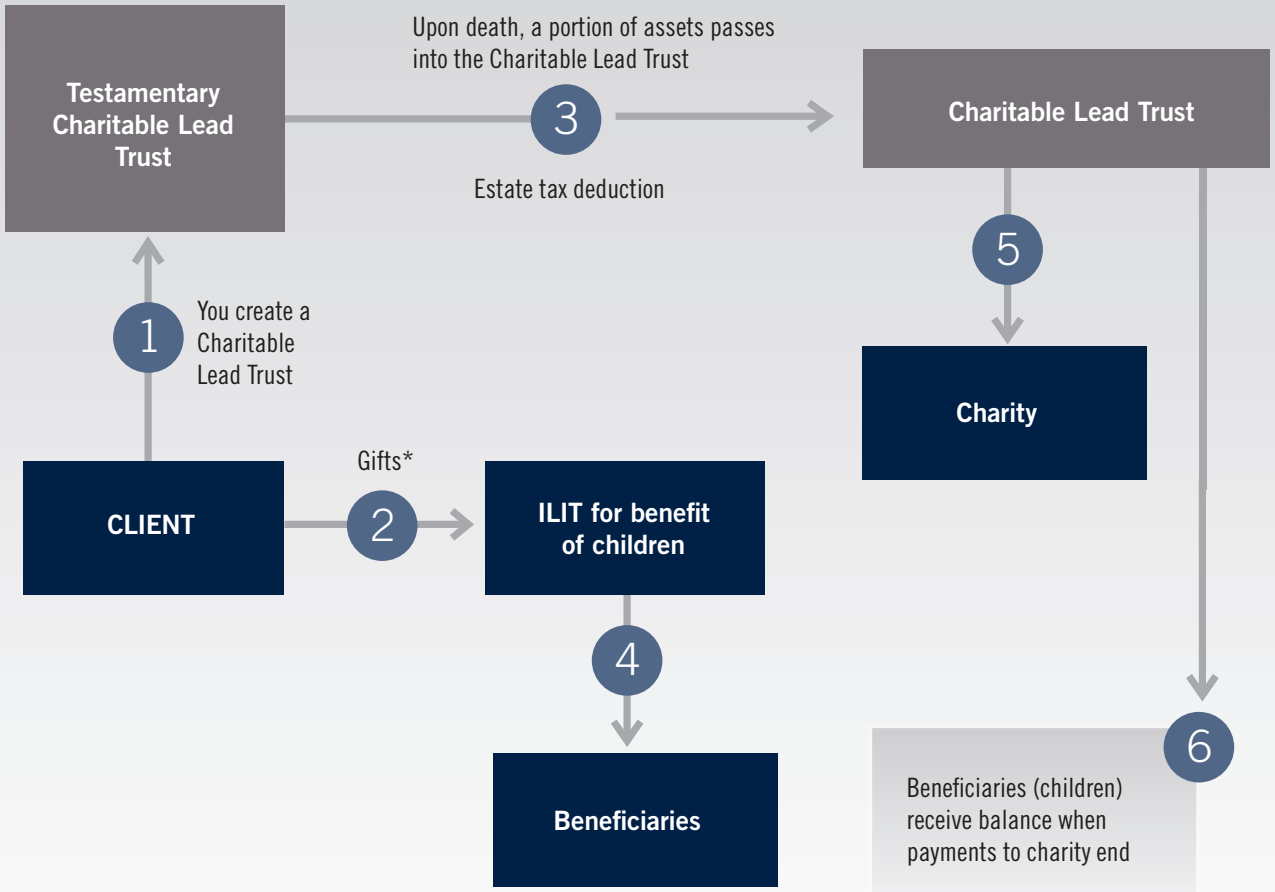
TESTAMENTARY CHARITABLE LEAD TRUST

By combining the benefits of a testamentary Charitable Lead Trust with life insurance, you may:

- Significantly reduce estate tax exposure
- Provide an annuity payment stream to a charity of your choice
- Be able to leave the entire value of your assets to your children

A testamentary Charitable Lead Trust is a split-interest charitable trust established at death, to which a significant amount of a person's estate may be transferred. Under the terms of the trust, a charitable beneficiary receives an income stream for a number of years. After the last payment, the remaining balance of the trust property is transferred to the decedent's non-charitable beneficiaries, typically his or her children. The strategy can result in significant estate tax benefits because the value of the income stream benefiting the charity is deductible for estate tax purposes.

Although the Charitable Lead Trust reduces the estate tax exposure, it gives to the charity some of what the children would have received, and the children must wait a fair amount of time before receiving the remaining balance. Life insurance can be a fitting complement to a Charitable Lead Trust. By purchasing a life insurance policy within an ILIT, you may be able to replace the wealth lost to the charity under the lead trust with the life insurance death benefit. There may be gift tax consequences associated with the funding of an ILIT. The death benefit should be received by the ILIT federal income and estate tax-free and distributed to the trust beneficiaries in accordance with the terms of the trust.



HOW IT WORKS

1. You create a testamentary Charitable Lead Trust.
2. You create an ILIT, which purchases life insurance on your life using assets you gift to the trust.*
3. Upon death, a portion of assets passes to the Charitable Lead Trust. As a result, the estate receives a federal estate tax deduction.
4. The trustee of the ILIT collects the insurance proceeds income and estate tax-free to replace the assets passing to the Charitable Lead Trust and distributes them to beneficiaries according to the terms of the trust.
5. For a specified term of years, the trustee of the Charitable Lead Trust distributes a fixed amount of the Charitable Lead Trust assets to the named charity.
6. Upon the expiration of the term of years, the remaining balance of the Charitable Lead Trust assets is distributed to the children.

** There may be federal gift tax consequences associated with the funding of an ILIT.*

PROFILE

- HAS A LARGE IRA
- GENERALLY AGE 60+
- DOES NOT/WILL NOT NEED RMDS OR IRA INCOME FOR LIVING EXPENSES
- WANTS IRA TO BE LEFT INTACT FOR BENEFICIARIES TO ACCUMULATE TAX-DEFERRED (GENERALLY 10 YEAR MAXIMUM)

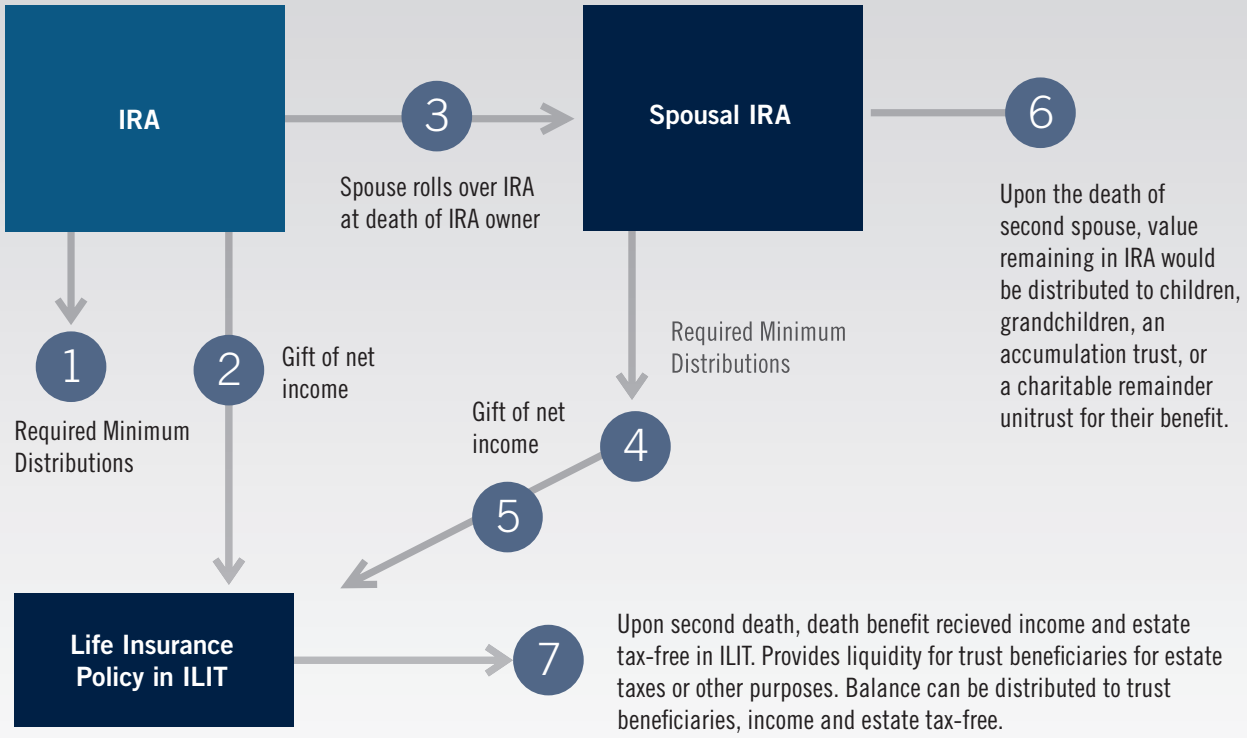
IRA DISTRIBUTION STRATEGY USING LIFE INSURANCE

Leaving an IRA in tax-deferred status for as long as possible enhances the benefits of the tax deferral for beneficiaries. However, there are three keys to success.

1. No more than the required minimum distribution should be taken each year by the participant and surviving spouse. This ensures that the maximum amount stays tax-deferred within the IRA.
2. With the passing of the SECURE Act, the "stretch IRA" concept is gone and all qualified retirement assets must now generally be distributed no later than the 10th year.*
3. In some cases most importantly, the clients must ensure that there is enough liquidity outside of the IRA to pay any estate taxes that may be due upon the IRA balance passing to the beneficiaries.

If the IRA itself must be used to pay the estate taxes, it could significantly reduce the IRA balance and therefore reduce the overall benefit of the IRA strategy. One way to provide liquidity in a cost-efficient manner is to use all or a part of the IRA owner's net required minimum distributions to purchase life insurance inside a properly structured ILIT. The liquidity in the ILIT can help recover some of the amount lost to taxes.

*Except in cases of a spouse, a minor beneficiary, a chronically ill beneficiary, beneficiaries with special needs, or a beneficiary within 10 years of age of the owner of the IRA.



HOW IT WORKS

1. Owner of a large IRA, who does not need the assets to live on, takes only required minimum distributions.[1]
2. With gifts of net income from the distributions, owner funds an ILIT,[2] which in turn purchases a second-to-die life insurance policy on the IRA owner and spouse.
3. Upon the death of the IRA owner, the surviving spouse elects a rollover to his or her own IRA.
4. The surviving spouse continues to take only required minimum distributions.[1]
5. The surviving spouse continues to use part or all of the net IRA distributions to fund the ILIT.
6. Upon second death, the remaining IRA balance is segregated into separate portions for each beneficiary so that each individual beneficiary may distribute the balance, generally within 10 years, as appropriate for their own situation.
7. At the same time, the ILIT receives the life insurance proceeds federal income and estate tax-free. These proceeds may provide liquidity for the trust beneficiaries to pay any estate taxes or other settlement costs they owe, leaving the remaining separate IRA accounts intact to accumulate tax-deferred, up to 10 years (for most beneficiaries).

[1] *Taxable distributions (and certain deemed distributions) are subject to ordinary income tax.*

[2] *There may be federal gift tax consequences associated with the funding of an Irrevocable Life Insurance Trust.*

PROFILE

- HAS A LARGE IRA
- GENERALLY AGE 60+
- DOES NOT NEED THE IRA INCOME FOR LIVING EXPENSES
- DOES NOT WANT BENEFICIARY TO PAY INCOME TAXES ON DISTRIBUTIONS

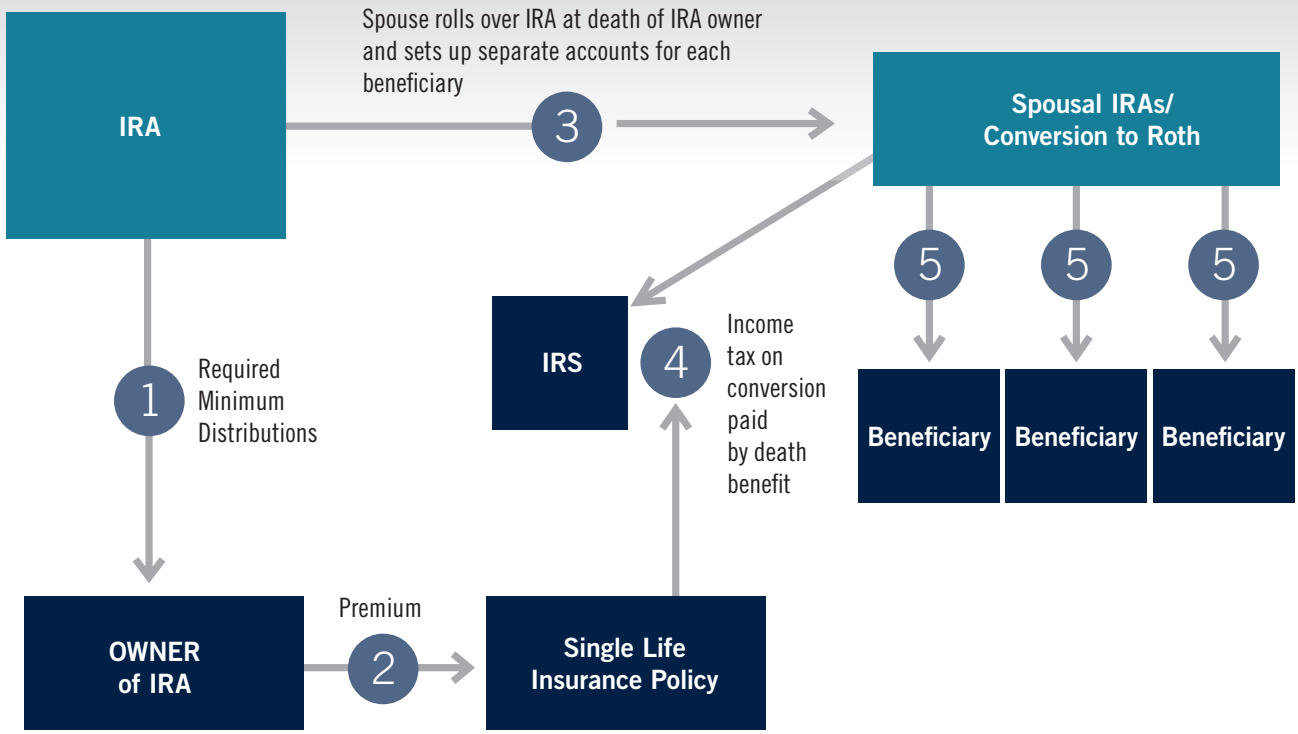
IRA DISTRIBUTION STRATEGY USING LIFE INSURANCE WITH ROTH CONVERSION

As with the previous strategy, the Stretch IRA Strategy Using Life Insurance with Roth Conversion also takes advantage of leaving an IRA in tax-deferred status for as long as possible (maximum of 10 years) to enhance the benefits of the tax deferral for beneficiaries. However, this strategy looks to further enhance the benefits of the Stretch IRA Strategy by converting from a traditional IRA to a Roth IRA for a number of reasons.

- There are no RMDs from a Roth IRA during the life of the owner and surviving spouse.
- Income taxes are due at the time of the conversion.
- The ability to defer taking RMDs until the death of the IRA owner further compounds the tax deferral of the IRA.
- Qualified distributions are not subject to income tax.

By properly implementing a stretch strategy with a Roth IRA, you can potentially pass on tax-free income to your loved ones.

For married couples, one strategy is for the surviving spouse to convert the traditional IRA to a Roth IRA after the death of the IRA owner. As a result of the conversion, the full balance of the IRA will be subject to income tax. If the surviving spouse has to use the money from the IRA to pay the income tax, it could significantly reduce the total balance and the overall benefit of the stretch strategy. Instead, to generate the liquidity necessary for paying the income taxes, life insurance is purchased ahead of time on the life of the original IRA owner using the net RMDs. The life insurance death benefit is used to pay the income taxes due on the conversion.



HOW IT WORKS

1. An owner of a large IRA takes Required Minimum Distributions (RMD).[1]
2. With the net after-tax income, the spouse purchases a life insurance policy on the IRA owner's life and is the beneficiary. Premiums are paid with the IRA owner's required minimum distribution.
3. Upon the death of the IRA owner, the surviving spouse rolls the IRA into his/her own and then converts to a Roth IRA. The surviving spouse also creates separate IRA accounts for each ultimate beneficiary.[2]
4. The life insurance death benefit is used to pay the income taxes on the conversion.
5. Spouse no longer needs to take RMDs. Upon her death, the full IRA balance passes to ultimate beneficiaries in separate accounts. Each beneficiary takes income tax-free required minimum distributions over his or her own individual life expectancy.

[1] *Taxable distributions (and certain deemed distributions) are subject to ordinary income tax and, if made prior to age 59½, may also be subject to a 10% income tax penalty.*

[2] *The remaining Roth IRA balance may be included in the owner's estate for federal estate tax purposes.*

Important Considerations

BEFORE IMPLEMENTING THESE STRATEGIES

- Any investment purchased involves the planning and use of your income or other assets. You should be certain to have sufficient liquid assets other than the asset or income you may be repositioning to support your current and future income and expenses before considering the purchase of a life insurance policy. Equity in the home should not be considered a liquid asset.
- You should consider developing a comprehensive financial strategy to take into account current and future income and expenses in conjunction with implementing any strategies discussed here.
- We recommend that you consult your tax and legal advisor to discuss your situation before implementing any strategies discussed here.

ABOUT THESE CONCEPTS

These concepts are only intended to be used for assets that will not be needed for living expenses for the expected lifetime of the insured. It is your responsibility to estimate these needs and expenses and it is recommended that you consider developing a comprehensive financial strategy in conjunction with implementing the strategy being considered. The accuracy of determining future needs and expenses is more critical for individuals at older ages who have less opportunity to replace assets used for the strategy.

Your financial or legacy situation may change

- If you need to use the assets or income being repositioned for current or future income needs and you can no longer make premium payments, the life insurance policy may lapse and the results illustrated may not be achieved.
- If the asset or income being repositioned becomes fully exhausted, premiums may have to be paid using other assets or income to keep the life insurance policy in force.

When these strategies may not be in your best interest

Depending on your life span, it is possible that your beneficiary may receive more by just inheriting the assets being repositioned, rather than by receiving the death benefit of the life insurance policy that was purchased.

Tax and other financial implications

There may be tax and other financial implications as a result of liquidating assets within an investment portfolio. If contemplating such a strategy, it is important to understand that life insurance is a long-term strategy to meeting particular needs.

The sale or liquidation of any stock, bond, IRA, certificate of deposit, mutual fund, annuity, or other asset to fund the purchase of a life insurance product may have tax consequences, early withdrawal penalties, and/or other costs or penalties as a result of the sale or liquidation.

Life insurance policy cash values are accessed through withdrawals and policy loans. Interest is charged on loans. In general, loans are not taxable, but withdrawals are taxable to the extent they exceed basis in the policy. Loans outstanding at policy lapse or surrender before the insured's death will cause immediate taxation to the extent of the gain in the policy. Unpaid loans and withdrawals reduce cash values and policy benefits and negate any guarantee against lapse.

If a policy is a Modified Endowment Contract (MEC), distributions (including loans) are taxable to the extent of income in the policy, and an additional 10% federal income tax penalty may apply. Consult your tax advisor for advice regarding your particular situation.

LOANS AND WITHDRAWALS

All accumulation that occurs within the policy is tax-deferred. You have the option to access any accumulation value in your policy through withdrawals and loans. Both loans and withdrawals from a permanent life insurance policy may be subject to penalties and fees and, along with any accrued loan interest, will reduce the policy's Account Value and Death Benefit.

LOANS

You should know that taking a loan has some risks. Policy loans (including outstanding loan interest):

- will decrease your death benefit
- may increase the risk that your policy will terminate
- will have a permanent effect on your Cash Surrender Value
- may impact the availability of some rider benefits
- may increase the premium necessary to keep the policy in force
- may have adverse tax consequences

WITHDRAWALS

Assuming the policy is not a Modified Endowment Contract (MEC), withdrawals generally are taxed only to the extent they exceed the policyowner's cost basis in the policy. The assets can be used at any time and for any need, offering you the freedom and flexibility to draw on your policy if you need it, when you need it. They can be used for any purpose you choose, for example, to help supplement retirement income, or even to help purchase a car or boat. A withdrawal reduces the Cash Surrender Value and can affect the Face Amount, Death Benefit, and net amount of risk (which is used to calculate the Cost of Insurance Charge). Withdrawals may increase the risk of policy lapse and may have unfavorable tax consequences.

MODIFIED ENDOWMENT CONTRACTS (MECS)

Federal tax law limits the amount of premium contributions that can be made to a policy in order for it to retain certain tax advantages. When premium contributions exceed this limit, the policy is classified as a modified endowment contract (MEC). Distributions from MECs (such as loans, withdrawals, and collateral assignments) are taxed less favorably than distributions from policies that are not MECs to the extent there is gain in the policy. For distributions from a MEC prior to age 59½, a federal income tax penalty may apply to the extent there is gain in the policy. However, death benefits are still generally received income tax-free pursuant to IRC §101(a). The death benefit will be reduced by any withdrawals or loans (plus unpaid interest). Clients should consult a tax advisor.

Before taking a withdrawal or a policy loan, we encourage you to work with your agent and trusted advisors to understand the financial impact a withdrawal or policy loan could have on your policy as well as any adverse tax consequences. If you have outstanding policy loans, ask to see a policy illustration showing the current impact of your loan on your policy's death benefit. Also, you should work with your agent to regularly check on your loan status to keep track of your loan and unpaid loan interest and to understand the amount of taxable income, should the policy lapse or be surrendered.

This material is being provided for informational or educational purposes only and does not take into account the investment objectives or financial situation of any client or prospective clients. The information is not intended as investment advice and is not a recommendation about managing or investing your retirement savings. If you would like information about your particular investment needs, please contact a financial professional.

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Guarantees are based on the claims-paying ability of the issuing company.

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