



## Private Flex Dollar

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President

Many wealthy individuals set up an irrevocable life insurance trust (ILIT) to purchase and own a life insurance policy on their life or, if married, a policy on both of the spouses' lives. The purpose is to provide ready liquidity at attractive risk adjusted returns for a variety of reasons including:

- Inheritance replacement or equalization
- Family wealth transfer
- Estate tax liquidity

Unless the ILIT already has substantial assets, the Grantor(s) will have to gift premiums. Often, the premium will be in excess of the annual exclusions available to the donor(s) and the donor may not be willing to use any remaining lifetime exemption or pay gift taxes attributable to the premium payments. As a result, a donor may not acquire the appropriate coverage, leaving the estate with insufficient liquidity.

### Private Flex Dollar

Private Flex-Dollar is an alternative to paying substantial gift taxes when life insurance premiums exceed the Donors(s) annual exclusions. It is a type of split dollar arrangement where a sponsor (generally a family member/insured) and an ILIT agree to split the benefits of a life insurance policy on the insured(s). Flex-Dollar arrangements are a way to use the most tax efficient structure of the split dollar and loan techniques at all times.

### How It Works

- Donor enters into a private split dollar arrangement with the trustee of an ILIT. The donor agrees to pay all of the premiums *minus* the economic benefit.
- The arrangement begins using the economic benefit treatment because at younger ages the economic benefit cost is low and usually much less than the interest on a loan (Figure 1).
- The policy is collaterally assigned and the donor acquires an interest in the policy that is the greater of the cumulative premium payments or the cash value. The ILIT retains the right to the balance of the death benefit, but it has no right to the cash value prior to the termination of the agreement.
- The donor gifts funds to the ILIT equal to the amount of the economic benefit. As an alternative, the donor could gift the full amount of the available annual exclusion and use the excess to fund a side fund in the ILIT which can later be used to repay the loan.

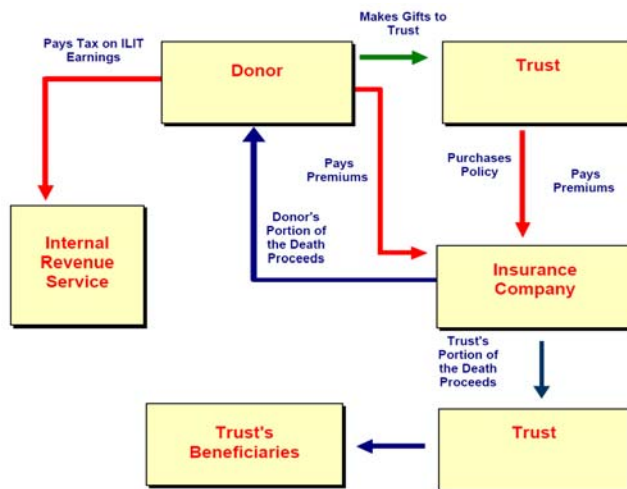


Figure 1 – Economic Benefit Regime



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- At a future date, the arrangement is converted from one using economic benefit treatment to a loan arrangement (Figure 2). The date chosen for the conversion may be the date the economic benefit cost equals the interest that would be due if the arrangement was treated as a loan.
- Alternatively, the date chosen might be when the cash value of the policy equals the cumulative premiums paid **or** upon the first death when survivorship is
- After the conversion to the loan, the ILIT pays or accrues interest on the loan principal outstanding. In some cases it may be possible for the ILIT to repay the donor from policy values or existing trust assets.
- To avoid an imputed gift to the ILIT the amount repaid to the donor at conversion should not be less than the Fair Market Value of the policy.
- Once the private split dollar arrangement has been converted to a loan, the loan can be carried until the death of the insured. Like any loan, this one may be retired by repayment of the outstanding principal to the lender.

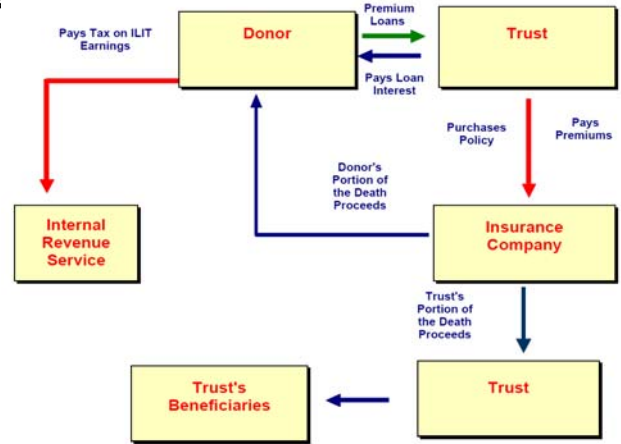


Figure 2 – Loan Regime

The table below shows the possible benefits of this strategy. Results are not guaranteed.

Yr	Age		Annual Premium	Donor			ILIT					
	Mal	Fem		Share of Premium	Annual Gift	Death Benefit	Econ Benefit	Loan Interest	Loan Repay	Death Benefit	Assets EOY	Net to Heirs
1	55	55	\$298,525	\$298,312	\$48,000	\$298,312	\$213	\$0	\$0	\$9,701,688	\$50,654	\$9,752,342
2	56	56	298,525	298,262	48,000	596,573	263	0	0	9,403,427	104,294	9,507,721
3	57	57	298,525	298,225	48,000	894,798	300	0	0	9,105,202	161,113	9,266,315
4	58	58	298,525	298,190	48,000	1,192,988	335	0	0	8,807,012	221,305	9,028,317
5	59	59	298,525	298,159	48,000	1,491,147	366	0	0	8,508,853	285,076	8,793,928
10	64	64	0	0	48,000	1,491,147	1,234	0	0	8,508,853	663,790	9,172,643
20	74	74	0	0	48,000	1,491,147	9,530	0	0	8,508,853	1,799,445	10,308,298
25	79	79	0	0	48,000	1,491,147	25,961	0	0	8,508,853	2,590,028	11,098,881
30	84	84	0	0	48,000	1,491,147	0	59,646	0	8,508,853	3,479,113	11,987,966
35	89	89	0	0	48,000	0	0	0	1,491,147	10,000,000	3,068,859	13,068,859

Assume loan interest rate of 4% and return on ILIT assets of 6%. Annual exclusion gifts of \$48K are made each year to the ILIT. Insured(s) - Both Age 55 Preferred Non-Smoker. Policy Design - \$10M of Survivorship Universal Life with guaranteed death benefit, funded with 5 annual premiums. Program converted to loan at Age 85 (when economic benefit exceeds loan interest). Loan repaid at Age 90. Insured(s) have annual exclusion gifts of \$48K available which are made each year to the ILIT. Economic benefit amounts assume both insureds are alive in all years until conversion to loan regime.

### Exit Strategies

In order to unwind the arrangement, adequate assets need to reside in the trust to satisfy the obligation owed to the payee. Different strategies work better than others depending on a variety of factors such as:

- The structure of the trust (single generation or GST exempt)
- What types of assets can be transferred to the trust
- Annual exclusion / Lifetime exemption availability
- Tolerance for complexity / Over all estate planning goals

Some common exit strategies include repaying loan at death, funding trust each year with annual exclusion gifts, funding trust with the remainder interest of a Grantor Retained Annuity Trust (GRAT), and gifting underwater stock options to ILIT. An appropriate exit strategy should be carefully reviewed with your advisors prior to entering into a Private Flex Dollar arrangement.