CONTINUING EDUCATION

LIFE INSURANCE PLANNING WITH FINANCED PREMIUMS

CE Seminar Attendee Booklet

October 2008

TRANSAMERICA
INSURANCE & INVESTMENT GROUP

Transamerica Life Insurance Company

For producer use only. Not for distribution to the public.

This material was not intended or written to be used, and cannot be used, to avoid penalties imposed under the Internal Revenue Code. This material was written to support the promotion or marketing of the products, services, and/or concepts addressed in this material. Anyone to whom this material is promoted, marketed, or recommended should be advised to consult with and rely solely on their own independent advisors regarding their particular situation and the concepts presented here.

Transamerica Insurance & Investment Group ("Transamerica") and its representatives do not give ERISA, tax, or legal advice. This presentation is provided for informational purposes only and should not be construed as ERISA, tax, or legal advice.

Discussions of the various planning strategies and issues are based on our understanding of the applicable federal income, gift, and estate tax laws in effect at the time of this presentation. However, tax laws are subject to interpretation and change, and there is no guarantee that the relevant tax authorities will accept Transamerica's interpretations. Additionally, this material does not take into consideration the general tax and ERISA provisions applicable to qualified retirement plans or the applicable state laws of clients and prospects.

Although care is taken in preparing this material and presenting it accurately, Transamerica disclaims any express or implied warranty as to the accuracy of any material contained herein and any liability with respect to it. This information is current as of October 2008.

Transamerica Insurance & Investment Group is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be addressed to the National Registry of CPE Sponsors, 150 Fourth Avenue North, Suite 700, Nashville, TN 37219-2417. Web site: www.nasba.org.

In the state of New York, Transamerica Life Insurance Company is an approved provider of continuing education courses (Provider Organization Approval Number NYPO-100366).

Slide #1:
Life Insurance Planning with Financed Premiums

Continuing Education
October 2008

Slide #2
Premium Financing

An important part of any high-net-worth client's financial picture

Premium Financing

Life insurance is an important part of any high-net-worth client's financial picture. Since ensuring adequate life insurance coverage usually requires significant premium payments, the premium financing strategy can be a good option for high-net-worth clients who do not want to liquidate assets to fund their life insurance premiums.

Premium financing is a program in which a business, a trust, or an individual borrows premiums from a third-party lender unrelated to the insurance company issuing the life insurance policy. This seminar will discuss how to set up a premium financing arrangement, and also identify some unique situations in which premium financing can be used to fund an IRC § 1035 exchange, or can rescue split-dollar cases.

Slide #3
Premium Financing as a Tool

Standard Model

Client-established trust borrows money from third-party lender unrelated to life insurance carrier

Premium Financing as a Tool: Standard Model

Generally, most lenders limit premium borrowers to individuals, trusts—both revocable and irrevocable—and business entities such as partnerships, limited liability companies, and corporations. In the "standard model," a client establishes an irrevocable trust that borrows money from a third-party lender unrelated to the life insurance carrier issuing the policy the trust will eventually own.

Financing premiums generally makes sense when the interest rate charged on the loan is lower than the return the client would expect to earn on the assets he or she would otherwise need to liquidate in order to pay the life insurance premiums.

The life insurance policy and loan qualification are evaluated as independent and separate transactions. In some instances, the insured may qualify for the insurance coverage, but the trust may not qualify for the loan.

Slide #4

Premium Financing as a Tool

Loan Collateral

- Insured must take on a significant amount of risk
- Trust pledges collateral, and typically grantor personally guarantees loan
- Policy cash surrender value is collaterally assigned to lender

Loan Collateral

The trust needs to qualify for the loan. Initially, the grantor might need to pledge some of his or her assets as loan collateral. This collateral requirement may be reviewed annually, since the borrower's financial situation may change unexpectedly over time. Eventually, the policy cash surrender value should become substantive enough to serve as collateral. The trust grantor is also typically required to personally guarantee the loan.

The lender may have the right to cancel or "call" the loan in the event the borrower, or the individual guaranteeing the loan, defaults on the loan repayment.

Slide #5

Premium Financing as a Tool

Other acceptable loan collateral includes

- Cash
- Bonds
- Securities
- Letters of credit
- Cash surrender values of other life insurance contracts

Other Acceptable Loan Collateral

Several options are available to guarantee the loan, including cash, bonds, securities, letters of credit, or cash surrender values of other life insurance contracts. When securities are pledged as collateral, they may be subject to a 50% discount. For example, if one million dollars in collateral is needed to secure the loan, then two million dollars' worth of securities in the client's portfolio would be required as acceptable collateral.

Slide #6

Premium Financing as a Tool

Interest Component

- May be variable but with predetermined, fixed spread
- Spread may be fixed for life of loan
- Interest is payable on annual basis in advance, in arrears or may be deferred

Interest Component

The interest rate may be variable or tied to a fluctuating rate, with a fixed spread that is predetermined. The lender typically determines the spread on a case-by-case basis, taking into account the amount of the loan and the lender's perceived risk. The current year's London Interbank Offered Rate (LIBOR) is usually the basis used in conjunction with a fixed spread to achieve the loan's ultimate interest rate.

Slide #7

Premium Financing as a Tool

Prepayment and Repayment Options

- **Prepayment—**depending on the lender, there may be no prepayment penalty
- **Repayment—**loan can be repaid from:
  - Death benefit
  - Policy cash value
  - Grantor Retained Annuity Trust funds
  - Term policy used to hedge against premium finance loan
  - Cash/liquidity event

Prepayment and Prepayment Options

Depending on the lender, there may be no prepayment penalty associated with paying off a premium finance loan. A borrower has many options in determining an appropriate repayment method. The loan may be paid out of the policy's death benefit; the balance of the proceeds then passes to beneficiaries. Alternatively, the borrower may withdraw the policy's cash value to pay off all or a portion of the loan. A borrower also has the option of creating a Grantor Retained Annuity Trust (GRAT), naming the trustee of his or her Irrevocable

Life Insurance Trust (ILIT) as the GRAT beneficiary. The ILIT trustee would then use GRAT funds to pay off the premium finance loan.

Of course, the occurrence of a liquidity event—such as the sale of a business—is an excellent exit strategy. A premium finance loan may also be paid off through the use of a term policy, purchased to hedge against the cost of the loan. For example, a policy owner with excess capacity and whose loan balance will be X amount in year 20 may purchase a term policy at the same time that he or she purchases a UL policy. In electing this exit strategy, a policy owner is essentially betting that he or she will not outlive the specific term of 20 years. Assuming that the policy owner is correct, both policies will pay out and the term policy for X amount can be used to pay off the premium finance loan for X amount—leaving the entire face amount of the UL policy to be paid to beneficiaries.

Slide #8

Premium Financing as a Tool

Modified Endowment Contract Issues

- Creating MEC not advisable in premium financing situation
- Collateral assignment on policy causes taxable gain to policy owner up to loan amount
- May be subject to penalty tax

Modified Endowment Contract Issues

It is inadvisable to create a Modified Endowment Contract (MEC) in a premium financing situation, because when the lender places a collateral assignment on the policy, the policy owner loses the tax-deferred growth of policy cash values. Once the policy cash values exceed the total amount of premiums paid, the policy owner would recognize income on the policy's gain. The taxable amount may also be subject to a 10% federal income tax penalty if the owner is under age $59\frac{1}{2}$ at the time income is realized.

Slide #9

Premium Financing as a Tool

Deductibility of Loan Interest

- Individual/trust: No income tax deduction
- Corporation/business: Deductibility depends on particular situation

Never suggest to an individual or corporate client that interest associated with a premium-financed life insurance policy is income tax deductible. Clients must consult with their own tax counsel to determine if loan interest is deductible in their particular situation.

Deductibility of Loan Interest

The Internal Revenue Service (IRS) has repeatedly denied individual taxpayers a deduction for interest paid on amounts borrowed for the payment of life insurance premiums, as it is deemed to be personal interest per IRC section 264.

In cases involving a corporate- or business-owned life insurance policy, the corporation or business may be able to deduct the interest in certain situations. You should never suggest to an individual or corporate client that the interest associated with a premium-financed life insurance policy is income tax deductible. Clients must consult with their own tax counsel to determine if the loan interest is deductible in their particular situation.

Slide #10

Premium Financing as a Tool

Gift Tax Issues

- Is personal guarantee a gift from grantor to trust?
  - No tax until completion of gift
  - Private Letter Ruling 9113009
  - Private Letter Ruling 9409018

Gift Tax Issues

Does a grantor's personal guarantee constitute a gift from the grantor to the trust? If a payment is made under the guarantee, the grantor will likely be deemed to have made a completed gift, for gift tax purposes. At the outset, however, only the guarantee has been made and no payment is required. It is uncertain whether a personal guarantee, in and of itself, constitutes a completed gift.

In general, there is no taxable gift until the transfer of the property involved is completed. The taxable act of making the transfer is completed only by the cessation of the donor's individual dominion and control, per Treasury Regulation § 25.2511-2. In Private Letter Ruling (PLR) 9113009, the IRS found a guarantee to be a completed gift as soon as it became legally enforceable. However, the IRS subsequently withdrew this PLR's finding with the issuance of PLR 9409018. The IRS has indicated that it is still considering its position on this issue.

Slide #11

Premium Financing as a Tool

Estate Tax Issues

- Is personal guarantee an incident of ownership in policy that causes policy proceeds to be includible in gross estate of insured/grantor?
  - PLR 9809032

Estate Tax Issues

In most premium financing cases, the policy is owned by an irrevocable trust. This arrangement is intended to keep the life insurance proceeds from being included in the estate of the insured/grantor. In most cases, the grantor will be required to make a personal guarantee of the loan. Whether a personal guarantee constitutes an incidence of ownership in the policy and, therefore, causes the policy proceeds to be includible in the gross estate of the insured, is an important estate tax concern.

In PLR 9809032, the IRS ruled that even though an irrevocable trust had borrowed funds from the insured to pay life insurance premiums and the loan remained outstanding at death, the life insurance proceeds payable to the trust as beneficiary were not includible in the insured/grantor's estate. However, keep in mind that IRS Private Letter Rulings are only applicable to the specific taxpayer who requested the ruling and to the specific facts presented in the taxpayer's request.

Slide #12

Premium Financing as a Tool

Example: Client Ima Blueblood

- 70-year-old female
- 3 children and 5 grandchildren
- Estate value: $10 million
  - $5 million invested in real estate
  - $5 million invested in securities

What recommendations do you have for Ima?

Example: Client Ima Blueblood

Ima Blueblood is a 70-year-old divorced woman looking for help with her estate plan. She explains that she has three children and five grandchildren. She has also amassed a sizable estate worth approximately $10 million. At present, her assets are split equally between a stock portfolio and numerous real estate holdings. Ima enjoys a sizable income from her property rentals, and uses much of the cash flow to maintain her comfortable standard of living. She is reluctant to deplete her stock portfolio to fund life insurance premiums, preferring to keep it as a “security blanket.” To date, Ima has not used any portion of her lifetime gift exemption, nor has she made any annual gifts to her children and grandchildren. At her death, however, Ima wants to transfer as much wealth as possible to them.

Based on Ima’s wish to leave as much of her estate as possible to her family, she might consider establishing an irrevocable life insurance trust and have the trustee purchase a life insurance policy on her life. In order to maximize the benefits from her lifetime gift exemption, the trustee should purchase the policy using a premium financing strategy.

Slide #13

Example: Illustration for Ima Blueblood

Financed columns: 1–10

- Premium/Cumulative Loan (col. 1 & 2)
- Interest (col. 3)
- Retained Capital Accounts (col. 4 & 5)
- Net Outlay (col. 6)
- Retained Capital (col. 7)
- Net Death Benefit (col. 8)
- Death Benefit with Retained Capital (col. 9)
- IRR at Death (col. 10)

Nonfinanced columns: 11-13

- Policy purchased if no financing involved

Example: Illustration for Ima Blueblood

Here is what Ima’s premium financed policy might look like. Shown are the cumulative loan needed to fund the life insurance policy, the interest that will be owed by the trust, and how much of the death benefit will remain after the loan is repaid. One of the more powerful findings shown in this illustration is the comparison between the financed and nonfinanced insurance alternatives.

SAMPLE PREMIUM FINANCING ILLUSTRATION

Loan Interest is not deductible. This example does not take into consideration any assumption regarding income, gift, or estate tax. Please consult your tax advisor.
Illustrated with a Account Retained Capital Account---Specified Payment with a Withdrawal from Retained Capital Account to Pay Interest

Policy was illustrated with a Return of Premium death benefit option on the finance portion.

FOR: Ima Blueblood
AGE: 70
CLASSIFICATION: FEMALE, PREFERRED NON-SMOKER

POLICY: Fixed UL Product
FACE AMOUNT: $5,000,000
ISSUER: Transamerica

	Finance												*Non-Finance*	
Year	Annual Insurance Outlay	Cumulative Loan	Annual Loan Rate	Annual Interest to Pay	Retained Capital Deposit	Retained Capital Withdrawal to Pay Interest	Annual Retain Capital Rate	Retained Capital Account	Policy Surrender Value	Policy Surrender Value Net of Loan	Death Benefit Net of Loan	Death Benefit with Retained Capital	Annual Insurance Outlay	Death Benefit
	(1)	(2)	(3a)	(3)	(4)	(5)	(6a)	(7)	(7a)	(7b)	(8)	(9)	(11)	(12)
1	(307,126)	(307,126)	6.00%	(18,428)	(1,096,000)	18,428	8.00%	1,163,778	0	(307,126)	5,000,000	6,163,778	(201,605)	5,000,000
2	(307,126)	(614,252)	6.00%	(36,855)	(96,000)	36,855	8.00%	1,320,757	264,238	(350,014)	5,000,000	6,320,757	(201,605)	5,000,000
3	(307,126)	(921,378)	6.00%	(55,283)	(96,000)	55,283	8.00%	1,470,392	551,611	(369,767)	5,000,000	6,470,392	(201,605)	5,000,000
4	(307,126)	(1,228,504)	6.00%	(73,710)	(96,000)	73,710	8.00%	1,612,097	846,403	(382,101)	5,000,000	6,612,097	(201,605)	5,000,000
5	(307,126)	(1,535,630)	6.00%	(92,138)	(96,000)	92,138	8.00%	1,745,235	1,147,474	(388,156)	5,000,000	6,745,235	(201,605)	5,000,000
6	(307,126)	(1,842,756)	6.00%	(110,565)	(96,000)	110,565	8.00%	1,869,124	1,435,867	(406,889)	5,000,000	6,869,124	(201,605)	5,000,000
7	(307,126)	(2,149,882)	6.00%	(128,993)	(96,000)	128,993	8.00%	1,983,021	1,733,250	(416,632)	5,000,000	6,983,021	(201,605)	5,000,000
8	(307,126)	(2,457,008)	6.00%	(147,420)	(96,000)	147,420	8.00%	2,086,129	2,041,656	(415,352)	5,000,000	7,086,129	(201,605)	5,000,000
9	(307,126)	(2,764,134)	6.00%	(165,848)	(96,000)	165,848	8.00%	2,177,583	2,362,682	(401,452)	5,000,000	7,177,583	(201,605)	5,000,000
10	(307,126)	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	2,256,452	2,696,729	(374,531)	5,000,000	7,256,452	(201,605)	5,000,000
	(3,071,260)			(1,013,516)	(1,960,000)	1,013,516							(2,016,050)	
11	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	2,341,631	2,746,416	(324,844)	5,000,000	7,341,631	0	5,000,000
12	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	2,433,624	2,798,839	(272,421)	5,000,000	7,433,624	0	5,000,000
13	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	2,532,976	2,838,835	(232,425)	5,000,000	7,532,976	0	5,000,000
14	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	2,640,276	2,866,841	(204,419)	5,000,000	7,640,276	0	5,000,000
15	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	2,756,161	2,880,527	(190,733)	5,000,000	7,756,161	0	5,000,000
16	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	2,881,316	2,870,978	(200,282)	5,000,000	7,881,316	0	5,000,000
17	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	3,016,484	2,837,274	(233,986)	5,000,000	8,016,484	0	5,000,000
18	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	3,162,465	2,774,248	(297,012)	5,000,000	8,162,465	0	5,000,000
19	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	3,320,124	2,675,717	(395,543)	5,000,000	8,320,124	0	5,000,000
20	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	3,490,396	2,534,582	(536,678)	5,000,000	8,490,396	0	5,000,000
	(3,071,260)			(2,856,272)	(2,920,000)	2,856,272							(2,016,050)	
21	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	3,674,290	2,325,419	(745,841)	5,000,000	8,674,290	0	5,000,000
22	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	3,872,896	2,046,364	(1,024,896)	5,000,000	8,872,896	0	5,000,000
23	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	4,087,390	1,678,055	(1,393,205)	5,000,000	9,087,390	0	5,000,000
24	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	4,319,044	1,194,191	(1,877,069)	5,000,000	9,319,044	0	5,000,000
25	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	4,569,229	558,002	(2,513,258)	5,000,000	9,569,229	0	5,000,000
26	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	4,839,430	0	(3,071,260)	5,000,000	9,839,430	0	5,000,000
27	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	5,131,247	0	(3,071,260)	5,000,000	10,131,247	0	5,000,000
28	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	5,446,409	0	(3,071,260)	5,000,000	10,446,409	0	5,000,000
29	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	5,786,784	0	(3,071,260)	5,000,000	10,786,784	0	5,000,000
30	0	(3,071,260)	6.00%	(184,276)	(96,000)	184,276	8.00%	6,154,389	0	(3,071,260)	5,000,000	11,154,389	0	5,000,000
	(3,071,260)			(4,699,028)	(3,880,000)	4,699,028							(2,016,050)	

Slide #14

Unique Policy Situations

Loan Rescue: Section 1035 Exchange

- Existing life insurance policy has sizable outstanding loan
- IRC § 1035 exchange might extinguish existing loan
- Concept of "boot" and unfavorable tax consequences

Loan Rescue: Section 1035 Exchange

Typically, when one life insurance contract is exchanged for another via an IRC § 1035 exchange, there is no taxable event that occurs. However, if an outstanding policy loan is extinguished rather than carried over to a new policy received in an IRC § 1035 exchange, the transaction may not be completely tax-free. IRC § 1035 provides that the amount of the extinguished loan, called "boot," is considered "other property," or cash, received as the result of the exchange. Therefore, the owner will have to recognize income equal to the lesser of the gain in the contract or the amount of the outstanding loan.

Example:

Cost basis (premiums paid) of the old policy = $400,000

Cash value = $600,000

Outstanding loan on the old policy = $160,000

During an exchange, the loan is extinguished. Since there is a total gain of $200,000 ($600,000 – $400,000), the policy owner must recognize the extinguished loan of $160,000 as ordinary income. This result is consistent with the conclusion reached in Example 1 of Treasury Regulation Section 1.1031(b)-1(b).

Slide #15

Potential Solution

Loan Rescue: Section 1035 Exchange (Cont.)

- Trust borrows amount of outstanding loan from lender
- Lender pays policy loan, sending cash directly to original issuing insurance company
- Trust then executes IRC § 1035 exchange with no boot in transaction

Loan Rescue: Section 1035 Exchange (Continued)

Assuming the lender's financial criteria can be met, the irrevocable trust—assuming it owns the policy—could borrow an amount equal to the amount of the existing policy's outstanding loan from the lender before executing the IRC § 1035 exchange. In this situation, the lender would pay off the policy loan by sending cash directly to the original issuing insurance company in an amount equal to the outstanding debt. The trust would then execute the IRC § 1035 exchange with no boot in the transaction.

Further premiums paid on the new policy might also be borrowed from the lender. The new policy will most likely serve as collateral for the loan. The lender will require a collateral assignment on the new policy for both the amounts borrowed to extinguish the previous policy loan, as well as those to fund any additional premium payments. In making the decision to borrow further premium amounts, the trustee should compare the cost of paying interest on the new loan to the tax liability that would result if the existing loan were extinguished during the exchange.

SAMPLE PREMIUM FINANCING ILLUSTRATION

Loan Interest is not deductible. This example does not take into consideration any assumption regarding income, gift, or estate tax. Please consult your tax advisor.
Illustrated with a Account Retained Capital Account---Specified Payment with a Withdrawal from Retained Capital Account to Pay Interest

Policy was illustrated with a Return of Premium death benefit option on the finance portion.
A 1035 Exchange of $1,250,000 was made into the policy in year one.

FOR: I.M. Loaded
AGE: 70
CLASSIFICATION: MALE, PREFERRED NON-SMOKER

POLICY: Fixed UL Product
FACE AMOUNT: $2,254,000
ISSUER: Transamerica

	Finance														Non-Finance		
Year	Annual Insurance Outlay	Cumulative Loan	Annual Loan Rate	Annual Interest to Pay	Retained Capital Deposit	Retained Capital Withdrawal to Pay Interest	Net Outlay	Annual Retain Capital Rate	Retained Capital Account	Policy Surrender Value	Policy Surrender Value Net of Loan	Death Benefit Net of Loan	Death Benefit with Retained Capital	IRR at Death	Annual Insurance Outlay	Death Benefit	IRR at Death
	(1)	(2)	(3a)	(3)	(4)	(5)	(6)	(6a)	(7)	(7a)	(7b)	(8)	(9)	(10)	(11)	(12)	(13)
1	(1,250,000)	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	8,100	1,064,320	564,320	3,004,000	3,012,100	7430.25%	(40,000)	2,000,000	4900.00%
2	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	16,848	1,087,244	587,244	3,004,000	3,020,848	720.47%	(40,000)	2,000,000	558.87%
3	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	26,296	1,112,273	612,273	3,004,000	3,030,296	285.03%	(40,000)	2,000,000	229.68%
4	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	36,500	1,136,262	636,262	3,004,000	3,040,500	163.43%	(40,000)	2,000,000	133.16%
5	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	47,519	1,157,449	657,449	3,004,000	3,051,519	110.15%	(40,000)	2,000,000	89.85%
6	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	59,421	1,169,085	669,085	3,004,000	3,063,421	81.12%	(40,000)	2,000,000	65.92%
7	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	72,275	1,179,235	679,235	3,004,000	3,076,275	63.15%	(40,000)	2,000,000	50.98%
8	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	86,157	1,190,166	690,166	3,004,000	3,090,157	51.06%	(40,000)	2,000,000	40.87%
9	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	101,149	1,201,440	701,440	3,004,000	3,105,149	42.43%	(40,000)	2,000,000	33.62%
10	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	117,341	1,213,049	713,049	3,004,000	3,121,341	36.01%	(40,000)	2,000,000	28.21%
	(1,250,000)			(325,000)	(75,000)	0	(400,000)								(400,000)		
11	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	134,828	1,225,234	725,234	3,004,000	3,138,828	31.06%	(40,000)	2,000,000	24.03%
12	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	153,715	1,233,862	733,862	3,004,000	3,157,715	27.15%	(40,000)	2,000,000	20.72%
13	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	174,112	1,233,948	733,948	3,004,000	3,178,112	23.99%	(40,000)	2,000,000	18.05%
14	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	196,141	1,224,285	724,285	3,004,000	3,200,141	21.40%	(40,000)	2,000,000	15.84%
15	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	219,932	1,204,074	704,074	3,004,000	3,223,932	19.24%	(40,000)	2,000,000	14.00%
16	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	245,627	1,170,966	670,966	3,004,000	3,249,627	17.42%	(40,000)	2,000,000	12.45%
17	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	273,377	1,119,975	619,975	3,004,000	3,277,377	15.86%	(40,000)	2,000,000	11.12%
18	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	303,347	1,047,144	547,144	3,004,000	3,307,347	14.52%	(40,000)	2,000,000	9.97%
19	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	335,715	945,962	445,962	3,004,000	3,339,715	13.37%	(40,000)	2,000,000	8.97%
20	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	370,672	811,002	311,002	3,004,000	3,374,672	12.36%	(40,000)	2,000,000	8.10%
	(1,250,000)			(650,000)	(150,000)	0	(800,000)								(800,000)		
21	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	408,426	625,990	125,990	3,004,000	3,412,426	11.47%	(40,000)	2,000,000	7.32%
22	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	449,200	387,541	(112,459)	3,004,000	3,453,200	10.69%	(40,000)	2,000,000	6.64%
23	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	493,236	80,405	(419,595)	3,004,000	3,497,236	9.99%	(40,000)	2,000,000	6.03%
24	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	540,795	0	(500,000)	3,004,000	3,544,795	9.38%	(40,000)	2,000,000	5.48%
25	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	592,158	0	(500,000)	3,004,000	3,596,158	8.83%	(40,000)	2,000,000	4.98%
26	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	647,631	0	(500,000)	3,004,000	3,651,631	8.34%	(40,000)	2,000,000	4.54%
27	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	707,541	0	(500,000)	3,004,000	3,711,541	7.90%	(40,000)	2,000,000	4.13%
28	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	772,245	0	(500,000)	3,004,000	3,776,245	7.51%	(40,000)	2,000,000	3.76%
29	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	842,124	0	(500,000)	3,004,000	3,846,124	7.16%	(40,000)	2,000,000	3.43%
30	0	(500,000)	6.50%	(32,500)	(7,500)	0	(40,000)	8.00%	917,594	0	(500,000)	3,004,000	3,921,594	6.84%	(40,000)	2,000,000	3.12%
	(1,250,000)			(975,000)	(225,000)	0	(1,200,000)								(1,200,000)		

Slide #16

Unique Policy Situations

Example: Client I.M. Loaded

- 70-year-old male
- $1,250,000 old policy cash value
- After IRC § 1035 exchange, death benefit increases to $3,004,000
- Annual premium reduced by $7,500

Example: Client I.M. Loaded

I.M. Loaded is a 70-year-old retired publishing executive. He is a wealthy single man reviewing financial matters with his team of advisors. He is especially concerned about an existing life insurance policy from which he has borrowed liberally to support his lifestyle. His professional advisors suggest that by financing an IRC § 1035 exchange, I.M. can pay off the existing loan, increase the policy's cash value, and lower his out-of-pocket premiums. Additionally, his resulting retained capital—the funds that would have been used to pay the policy loan—might be invested at a higher rate of return than the loan's interest rate.

The existing policy has a cash value of $1,250,000 and an outstanding loan of $500,000. With the premium financing arrangement, I.M.'s loan is paid off, his death benefit net of the loan is $3,004,000 using a Plus-Premium option, and his annual cash outlay is reduced from $40,000 to $32,500 because he is only paying interest on the loan from the lender instead of policy premiums.

Slide #17

Unique Policy Situations

Split-Dollar Arrangements: What is going on now?

- Final regulations

Split-Dollar Arrangements

Split-dollar arrangements have been used for decades as a popular business planning strategy to fund personal life insurance coverage. Final regulations issued by the IRS make reevaluating existing split-dollar plans crucial. For those plans that were in place on or before September 17, 2003, that have not been materially modified, the rules remain the same as long as the split-dollar arrangement remains in place.

However, any new split-dollar plans entered into after September 17, 2003, or any that have been modified since that date, must be in compliance with the final regulations. For new or amended plans, ownership of the policy is a key indicator as to whether the plan will fall under the regulation-defined economic benefit or loan regime.

Slide #18

Potential Solution

The Premium Financing Strategy: Endorsement split-dollar rescue

- Allows parties to split-dollar plan to terminate plan before death
- Eliminates possible income tax on employee from economic benefit
- Returns assets committed to plan to entity funding premiums

Endorsement Split-Dollar Rescue

Premium financing might be an option when the parties to an endorsement split-dollar plan wish to terminate the plan before the death of the insured(s). Besides eliminating possible future income taxes levied on the employee for realization of economic benefit from such a transaction, the business entity funding the premiums is repaid the money it had committed to the plan.

Slide #19

Potential Solution

The Premium Financing Strategy: Endorsement split-dollar plans

- Entity or trust that receives policy obtains loan from lender
- Loan proceeds used to repay premium sponsor of split-dollar plan
- Repayment amount should equal policy's fair market value

Endorsement Split-Dollar Plans

The entity purchasing the policy, often an intentionally defective grantor trust for the benefit of the insured's family, would obtain a loan and use the proceeds to repay the premium sponsor of the split-dollar plan. The repayment should equal the fair market value of the policy based on the final IRS valuation regulations outlined in Revenue Procedure 2005-25. Once the plan sponsor is repaid, the life insurance policy may be distributed to the insured or to an irrevocable trust, and may be followed by the assignment to the lender. This distribution would normally trigger a transfer-for-value tax, but if the policy is distributed to the insured or to a defective grantor trust, an exception may apply.

Slide #20

Unique Policy Situations

Premium Financing Considerations

- Some financing programs will not finance in-force policies
- Potential solution: Add new coverage to in-force policy or exchange policy for new one
- Compare cost of interest payable to income tax due on split-dollar plan

Premium Financing Considerations

Many financing programs will not finance in-force life insurance policies. In a split-dollar plan, however, they may loan the employee the money to repay the premium sponsor, thus allowing the relinquishing of any debt obligation the employee has to the employer. Once this occurs, the new policy may be exchanged via an IRC § 1035 exchange to a new policy. The premiums on the existing policy may be financed using the policy cash surrender value as collateral.

The two parties participating in the split-dollar arrangement need to weigh the cost of paying interest to the lender against the possible income tax consequences associated with an endorsement split-dollar plan, including the cost of having the sponsor's money remain committed to the life insurance policy. This analysis is easier if the sponsor's economic interests are the same as the insured's, but becomes more difficult if the insured is not an owner of the entity sponsoring the plan.

Slide #21

Potential Solution

Premium Financing: Bonus for interest due on split-dollar plan termination

- Employee wants financing to terminate split-dollar plan
- Business could pay employee bonus equal to loan interest
- If policy owned by Irrevocable Life Insurance Trust (ILIT), employee can gift interest to ILIT

Bonus for Interest Due on Split-Dollar Plan Termination

If the split-dollar plan is terminated through a financing program, the business has the option of paying a bonus to the employee equal to the interest costs associated with the loan. If the policy is owned by an ILIT, the employee would then need to gift the cash for the payment of interest to the trust. This transfer may or may not have gift tax consequences, depending on how the trust is structured and how much cash is gifted.

Slide #22

Unique Policy Situations

Premium Financing: Considerations for publicly traded companies

- Legal restrictions on publicly traded companies that make or arrange loans
- Use extra caution

Considerations for Publicly Traded Companies

Legal restrictions apply to publicly traded companies either making loans to certain employees or arranging financing for them. For such entities, extra caution needs to be observed when considering premium financing as a source of funding when terminating an economic benefit split-dollar plan.

Slide #23

Corporate Redemption with Multiple Policies

Example: Client Gee Whiz Games, Inc.

- 5 policies
- 1 borrower
- Premiums range from $10,000 to $60,000
- Cumulative loans qualify for premium financing based on minimum premium levels

Corporate Redemption with Multiple Policies

Premium financing is also a good tool for growing companies needing to keep assets liquid for reinvestment or emergencies. While an individual policy may not meet the required minimum premium amount, some financing companies may aggregate loans so that the acceptable premium amount is met.

Example: Gee Whiz Games, Inc.

Five college classmates from MIT designed a video game—Laurie Kraft, Pyramid Raider—as a class assignment. The entire class got hooked on the game, including the professor. Realizing the success of their game, they decided to form a company called Gee Whiz Games, Inc. to market and sell Laurie Kraft, Pyramid Raider to a wider audience. In one year, the value of their company grew from $80,000 to $3 million.

The attorney representing Gee Whiz has recommended setting up a buy-sell agreement to protect the principals and the business. They agree to set up a stock redemption plan in which the corporation owns a policy on each of the principals' lives. If a principal dies, the company will redeem his or her stock using the death benefit proceeds. Premiums on the policies range from $10,000 to $60,000 which, taken individually, will not meet the minimum premium level required for third-party premium financing of greater than $75,000.

However, since there is only one borrower—Gee Whiz Games, Inc.—it can qualify for premium financing based on the aggregate amount borrowed for the five policies. Through its use of premium financing, the company avoids liquidating assets to pay premiums, and can keep its cash available for reinvestment in Gee Whiz Games, Inc.'s future growth.

Slide #24

Identifying Prospects for Premium Financing

Likely Prospects

- Estate value over $5 million
- Traditional funding may have adverse gift tax results
- Client's investments illiquid but owns sufficient assets for collateral or can obtain letter of credit
- Satisfies minimum premium requirement on life insurance policy

Likely Prospects

Not all prospects qualify or are appropriate candidates for premium financing. Generally, a good prospect for financing will have an estate valued at greater than $5 million, and apply for a life insurance policy with a minimum required premium of $75,000. Affluent people for whom traditional premium funding may create an adverse gift tax situation are good candidates. It also typically helps those whose assets are illiquid to provide estate liquidity to pay taxes at death. Finally, acceptable prospects for premium financing must either be able to supply sufficient collateral to obtain a loan, or be able to provide an acceptable letter of credit to satisfy the lender's security requirements.

Slide #25

Identifying Prospects for Premium Financing

Likely Prospects (Cont.)

- Business entity needs large amount of life insurance and owns sufficient assets to serve as collateral
- Client understands advantages of leveraging and is comfortable with financing concept

Likely Prospects (Continued)

Final candidates to consider when thinking about premium financing are corporations or other business entities. While there are no gift tax implications, a corporation that needs to provide large amounts of life insurance to its employees may utilize its excess cash or other business assets as collateral for the loan, using corporate dollars to pay the interest.

When considering premium financing, the prospective client should understand its advantages in providing liquidity as well as its financial benefits from a gift-tax perspective. He or she should also be comfortable with the financing concept overall.

Slide #26

Proper Use of Premium Financing

- Does not reduce actual dollar cost of buying life insurance, since loan principal is eventually repaid to lender with interest
- Actual terms of each case will differ with lender and insurance carrier involved in premium financing program

Proper Use of Premium Financing

Premium financing does not reduce the actual dollar cost of buying life insurance, since the loan principal is eventually repaid to the lender with interest. The actual terms of each case will differ, depending on the lender and insurance carrier involved in each premium financing arrangement.

If interest rates are appropriate and the client's particular situation fits the characteristics of a premium financing arrangement, this strategy can not only be ideal for the prospect's liquidity and gift-tax concerns, but can satisfy his or her life insurance needs as well.

TRANSAMERICA
INSURANCE & INVESTMENT GROUP

Transamerica Life Insurance Company

OLA 986 T 1008 Life Insurance Planning with Financed Premiums CE Seminar Attendee Booklet

For producer use only. Not for distribution to the public.