



FINANCIAL PLANNING

A Diamond in the Rough

Private placement insurance's applications are vast although the product is often misunderstood.

Private placement life insurance (PPLI) was developed for the investing and insurance needs of the high-net-worth individual. Although it provides a major focus on cash value accumulation, it still offers a meaningful death benefit in compliance with the tax regulations of Internal Revenue Code Section 7702.

One of PPLI's primary attractions is its tax advantages. At its simplest level and structured properly in conformity with Code Section 7702, PPLI's premiums in life insurance accrete free of federal income tax during the life of the insured, and the death benefit passes to the beneficiary free of any federal income tax. A very favorable investment structure develops when coupled with underlying investments that are actively managed investments which would typically generate ordinary income (e.g., hedge funds, commodity funds and high-yield taxable bonds). The growth of the underlying assets free of any federal income tax turns an otherwise 8 percent after-tax return into a 12.3 percent return, for example.

The tax regime in the United States will change and most probably will result in an increase in the capital gains and

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ordinary income tax rates at both the federal and state levels. Table 1 compares the accretion within PPLI as compared to different tax rates. (See Table 1 below.)

The benefits

In each scenario presented in Table 1, PPLI generates the highest account value over the investment horizon on a tax-adjusted basis. During the life of the insured, the policy owner has access to the cash value without being subjected to income tax either through withdrawals of basis (i.e., cumulative premiums paid) or policy loans (provided the policy does not lapse prior to the death of the insured). This is another tremendous benefit of PPLI since it provides for another tax-adjusted savings vehicle without the limitations of a 401(k) plan or an IRA. However, as compared to

a 401(k) plan or an IRA, there is unrestricted access to the cash value of the policy, typically up to 90 percent of the accumulated cash value. This amount may be borrowed tax free, with net borrowing costs ranging from 0.25 percent to 1 percent. From a planning perspective, the living benefits can be used to fund lifestyle needs or capital expenditures.

The death benefit is sometimes overlooked in the PPLI context, but it is an incredibly important part of the planning process. The death benefit can be used for many planning applications, ranging from an estate-tax mitigation tool to a tool as complex as the payoff of a note in a split-dollar arrangement.

While the estate-tax landscape remains in flux, it is unquestioned that some form of estate tax will emerge over the next year. Beneficiaries will enjoy the liquidity created by the PPLI death benefit to help pay estate taxes and thus

Age	Premium/Investment	PPLI		After-Tax Values (application tax rate)		
		Cash Value	Death Benefit	20%	35%	40%
50	2,500	2,609	47,785	2,660	2,630	2,620
51	2,500	5,400	50,576	5,490	5,397	5,366
52	2,500	8,398	53,574	8,502	8,307	8,243
53	2,500	11,617	56,793	11,706	11,369	11,259
54	0	12,393	56,793	12,455	11,961	11,799
60	0	18,692	24,299	18,071	16,212	15,633
70	0	38,186	43,914	33,605	26,916	24,983
80	0	80,056	84,059	62,492	44,685	39,926
90	0	165,688	173,972	116,209	74,185	63,807

(The above amounts (expressed in thousands) reflect an 8 percent return, net of investment management fees. PPLI assumes a male, age 50, nonmodified endowment contract.)

limit other liquidations of an investment portfolio or a family business.

The death benefit may also be used to create a family legacy. The beneficiary of the death benefit could be a charity, a church, a school or a family foundation, or the death benefit can be used to create a private family foundation for future generations.

Split-dollar application

One advanced but highly effective planning technique is the use of a split-dollar premium payment arrangement. Split-dollar planning is a flexible framework that facilitates transferring wealth to future generations in a transfer-tax-efficient manner. For example, a senior generation can pass assets in a leveraged manner to the next generation with minimal transfer-tax liability by creating an irrevocable life insurance trust and by funding the insurance purchase through an alternative premium-paying arrangement, such as an intrafamily loan structured as a split-dollar

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arrangement under the applicable tax regulations. When a client's net worth suggests the need for removing substantial assets from the estate-tax base, PPLI, an ILIT and an intrafamily split-dollar loan can be a very effective combination.

In addition to the tax benefits of PPLI, the existence of life insurance in an estate can also serve as a powerful asset-protection tool. Prudent and wise planning requires wealthy individuals to create structures that prevent a complete loss of their estate due to a frivolous claim (although careful attention must be paid to the applicable fraudulent-conveyance rules). While a detailed discussion is outside the scope of this article, policy

ownership in jurisdictions outside the United States can further strengthen the asset protection of the life insurance ownership structure. In addition, certain jurisdictions statutorily protect the life insurance policy itself. □

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