



Private Placement Life Insurance

Robert W. Chesner, Jr.

Leslie C. Giordani

2301 S. CAPITAL OF TEXAS HWY, BUILDING K | AUSTIN, TEXAS 78746

phone 512.767.7100 | **fax** 512.767.7101 | GFGRLAW.COM

© 2009 – Present Giordani Fite Grossman & Ripp LLP. This report has been prepared for informational purposes only. It does not constitute an offer or solicitation for the purchase or sale by our firm to you or to any other person to acquire a life insurance product. The information contained herein has been obtained from sources believed to be reliable, but our firm cannot guarantee its accuracy or completeness.

Biographies

- Giordani Fitte Grossman & Ripp LLP (“GFGR”) delivers highly-personalized legal and non-legal wealth preservation, tax, and estate planning services to the high net worth community in the United States and abroad. Distinguished by a superb team of legal, tax, and insurance professionals, GFGR offers a comprehensive array of private client strategies at the highest level of quality—reasonably priced and timely delivered. The professionals and staff of GFGR seek to provide the highest quality legal services within the strictest ethical boundaries of the legal profession in a work environment that honors, respects, and values our clients, each other, our colleagues, and the community.
- Ms. Giordani primarily represents high net worth individuals and family offices in the design, implementation, and administration of domestic and international trust, investment, life insurance, and asset protection structures. She also consults generally to major financial institutions and boutique financial service providers on matters of interest to the high net worth marketplace. Ms. Giordani is board certified in Estate Planning and Probate Law (Texas Board of Legal Specialization), is listed in The Best Lawyers in America, and is a Fellow of the American College of Trust and Estate Counsel (ACTEC). A frequent author and speaker in the areas of life insurance, asset protection, and foreign trust planning, Ms. Giordani serves as a contributing author of the four-volume treatise, *Asset Protection: Domestic and International Law and Tactics* (Thomson/West Group, updated quarterly), and has also been interviewed for articles in various publications. She and Mr. Chesner co-authored the Bloomberg BNA Tax Management Portfolio 870, 1st, Private Placement Life Insurance and Annuities.
- Mr. Chesner leads the firm’s finance and insurance practice. In that role, he assists high net worth individuals and family offices in the design and implementation of domestic and offshore life insurance and annuity structures, consults on their property, liability, other risk management needs, and oversees the third party management of the clients’ investment portfolio. Mr. Chesner also serves as President of Edgewater Consulting Group, Ltd., a GFGR affiliate that provides a comprehensive post-sale service and consulting platform to insurance professionals, carriers, and policy owners in the private placement life and annuity marketplace. In addition to frequently publishing articles about private placement life insurance, he and Ms. Giordani co-authored the Bloomberg BNA Tax Management Portfolio 870, 1st, Private Placement Life Insurance and Annuities.

Federal Taxes on Investment Earnings and Wealth

| | Current Federal Tax Rate ¹ | |
|---|---------------------------------------|---|
| Ordinary Income ^{2,4} | 40.8% | All rates EXCLUDE state income tax |
| Short-Term Capital Gains ^{2,4} | 40.8% | |
| Long-Term Capital Gains ^{3,4} | 23.8% | |
| Dividends ^{3,4} | 23.8% | |
| Estate Tax ⁵ | 40.0% | |

¹ As a result of the Tax Cuts and Job Act of 2017.

² The top marginal income tax rate (for individuals with taxable income over \$500,000/joint filers over \$600,000).

³ The top marginal tax rate (over the \$400,000/\$450,000 income threshold) on long-term capitals gains and dividends increased from 15% to 20% as a result of American Taxpayer Relief Act of 2012.

⁴ A 3.8% tax imposed on net investment income by the Healthcare and Educational Reconciliation Act of 2010 (for individuals with taxable income over \$200,000/joint filers over \$250,000).

⁵ Subject to \$11.18 million individual estate and gift lifetime exclusion amount.

Income Tax Effect on an Investment Portfolio

| | Portfolio Deposit | No Taxation | | Current Tax Regime (40%) | |
|----|-------------------|-------------|-------|--------------------------|-------|
| | | Amount | IRR | Amount | IRR |
| 1 | (2,500) | 2,675 | 7.00% | 2,605 | 4.20% |
| 2 | (2,500) | 5,537 | 7.00% | 5,319 | 4.20% |
| 3 | (2,500) | 8,600 | 7.00% | 8,148 | 4.20% |
| 4 | (2,500) | 11,877 | 7.00% | 11,095 | 4.20% |
| 5 | | 12,708 | 7.00% | 11,561 | 4.20% |
| 10 | | 17,824 | 7.00% | 14,202 | 4.20% |
| 20 | | 35,062 | 7.00% | 21,429 | 4.20% |
| 30 | | 68,973 | 7.00% | 32,336 | 4.20% |
| 40 | | 135,680 | 7.00% | 48,794 | 4.20% |
| 50 | | 266,904 | 7.00% | 73,628 | 4.20% |

Assumptions:

1. 000's omitted
2. Assumes a 7% return after investment management fees
3. Assumes a combined federal and state income tax rate of 40%
4. Four annual investments of \$2.5 million

What is “Private Placement” Life Insurance?

- Variable universal life insurance product available as a private placement
- Institutional pricing
- Customized and negotiated
- Wide variety of underlying asset management choices for policy assets, including many hedge funds and alternative investments; flexibility in adding new asset management choices
- To purchase a U.S. private placement insurance product, investor typically must be an “accredited investor” who is a “qualified purchaser” under SEC rules
- Typically targeted toward \$4-5M investment or greater, although smaller amounts are possible

Benefits of Private Placement Life Insurance (“PPLI”)

- Tax-free investment environment for policy cash value
(especially good for alternative/hedge funds and other tax inefficient investments)
- Low cost structure *(should be less than 1.25% of invested amount per annum on average within 10-15 years)*
- Flexible
 - Broad selection of investment management strategies
 - Easy to change asset managers
 - Can withdraw/borrow from policy at minimal cost
(and tax free with proper structuring)
- Beneficiary receives death benefit free of income tax and, if structured properly, free of estate tax
- Underlying investments may be afforded higher levels of creditor protection by statute or through effective use of trusts *(domestic or international)*

How is PPLI different from Traditional / Retail Life Insurance?

Needs Based Insurance

*Retail
Life Insurance Funding*

**Maximized Net Amount
at Risk**
Death Benefit

Smaller Deposits
Made Over Long Time Period

Death Benefit
Purchase Goal

vs.

Investment Based Insurance

vs.

*Private Placement
Life Insurance Funding*

**Minimized Net Amount
at Risk**
Death Benefit

Larger Deposits
Made Over Short Time Period

Investment
Purchase Goal

Client Market for PPLI

- Individual investors with large investment portfolios
 - Investments in highly-taxed asset classes such as hedge funds, actively managed portfolios, taxable bonds, commodities, etc.
 - Primary goal - improve portfolio's overall tax efficiency
 - Secondary goals
 - Estate planning with death benefit liquidity
 - Protection of policy from claims of future creditors ("*asset protection*")
- Trustees seeking to optimize tax efficiency of trust assets
 - Exempt asset trusts (*trusts outside investor's estate*)
 - Trusts established by foreign persons that benefit U.S. taxpayers

Tax Compliance

- Definition of life insurance; IRC§7702
 - Policies must meet the definition of life insurance by passing one of two tests
 - CVAT (*cash value accumulation test*)
 - GPT/CVCT (*guideline premium/cash value corridor test*)
- Modified Endowment Contract (MEC); IRC§7702A
 - MEC policies are subject to additional taxation in the event of withdrawals or loans from policy cash values. MEC classification depends on premium funding levels and/or timing of premium payments

Tax Compliance *(continued)*

- Diversification; IRC§817(h)
 - In general, each asset account in a variable life policy must contain at least 5 investments (issuers) with:
 - No more than 55% of the account value represented by any one investment
 - No more than 70% of the account value represented by any two investments
 - No more than 80% of the account value represented by any three investments
 - No more than 90% of the account value represented by any four investments
 - Under regulations, non-insurance dedicated hedge funds and funds of funds count as one investment and are not “looked-through” to underlying investments

Tax Compliance *(continued)*

- Investor control
 - Although free to choose the investment manager, the policyowner may not have control over specific investment selections and there should be no “pre-arranged” plan with the investment manager
 - Rev. Rul. 2003-92
 - Non-insurance dedicated hedge fund is implied investor control
 - Insurance dedicated hedge funds are safe
 - Managed separate accounts not directly addressed; “facts and circumstances” test should continue to apply
- Failure to comply
 - Failure to comply with these rules results in loss of the tax benefits of life insurance

Typical Insurance Related Taxes and Fees

| Fee | Recipient | How Paid | Amount | |
|----------------------------------|---|--|---|-------------------------------------|
| | | | <i>International</i> | <i>Domestic</i> |
| DAC Tax | Insurance company | Assessed against each premium | 0% - 1.0% | 1% - 1.5% |
| Premium Tax | Insurance company | Assessed against each premium | 0% | 2%, on average (Varies by state) |
| Mortality & Expense (M&E) charge | Insurance company and insurance advisor | Monthly assessment against cash value | Typically scaled by asset size and duration (i.e., 0.50% of cash value per year for first 10 years; 0.40% for second 10 years; 0.20% thereafter) | |
| Cost of Insurance charge | Insurance company | Monthly assessment against cash value | Variable depending on net amount at risk, age, sex, and health of insured | |
| Compensation | Insurance advisor | Outside the policy or from initial premium and/or cash value (part of M&E) | Front-end (if any) – 1% of premium or less Trail compensation – 0.10-0.50% of cash value per annum | |

Pricing Rule of Thumb: The policy cash value's internal rate of return ("IRR") on investments should exceed the investor's after-tax non-insurance equivalent within the first few policy years, and by the tenth to fifteenth policy year and beyond, the policy cash value's IRR should be less than 125 basis points lower than the investment manager's pre-tax return, net of fees. For smaller premium investments, the break-even point between the policy's cash value IRR and the after-tax non-insurance equivalent may occur in later years.

Taxable Investment vs. PPLI

Four Annual Investments of \$2,500,000 – Non-MEC Male, Age 45, Preferred Non-Smoker

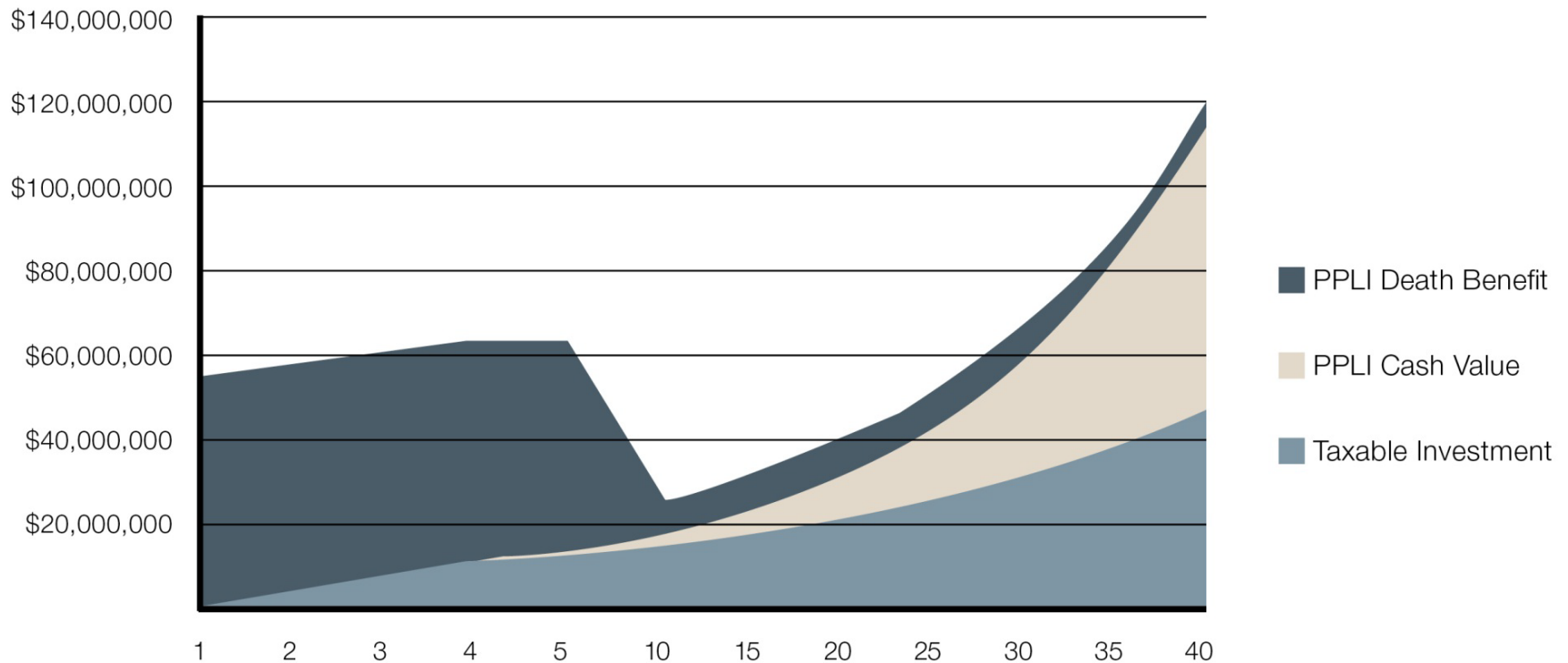
| Year | Age | Deposit | GROSS RETURN | | | TAXABLE INVESTMENT | | | PRIVATE PLACEMENT LIFE INSURANCE | | |
|------|-----|-------------|---------------|---------------|-------------------------|--------------------|-------------------------|----------|----------------------------------|-------------------------|---------------|
| | | | Annual Return | Account Value | Internal Rate of Return | Account Value | Internal Rate of Return | Tax Cost | Subaccount Value | Internal Rate of Return | Death Benefit |
| 1 | 45 | \$2,500,000 | 7.00% | \$2,675,000 | 7.00% | \$2,605,000 | 4.20% | 2.80% | \$2,604,845 | 4.19% | \$54,696,143 |
| 2 | 46 | 2,500,000 | 7.00% | 5,537,250 | 7.00% | 5,319,410 | 4.20% | 2.80% | 5,371,661 | 4.88% | 57,462,959 |
| 3 | 47 | 2,500,000 | 7.00% | 8,599,858 | 7.00% | 8,147,825 | 4.20% | 2.80% | 8,311,291 | 5.22% | 60,402,589 |
| 4 | 48 | 2,500,000 | 7.00% | 11,876,848 | 7.00% | 11,095,034 | 4.20% | 2.80% | 11,440,581 | 5.46% | 63,531,879 |
| 5 | 49 | – | 7.00% | 12,708,227 | 7.00% | 11,561,025 | 4.20% | 2.80% | 12,119,293 | 5.59% | 63,531,879 |
| 10 | 54 | – | 7.00% | 17,823,946 | 7.00% | 14,201,524 | 4.20% | 2.80% | 16,331,334 | 5.91% | 25,640,195 |
| 20 | 64 | – | 7.00% | 35,062,399 | 7.00% | 21,429,505 | 4.20% | 2.80% | 30,869,654 | 6.27% | 37,660,978 |
| 30 | 74 | – | 7.00% | 68,973,045 | 7.00% | 32,336,226 | 4.20% | 2.80% | 59,061,824 | 6.42% | 63,196,152 |
| 40 | 84 | – | 7.00% | 135,680,420 | 7.00% | 48,794,011 | 4.20% | 2.80% | 113,334,697 | 6.50% | 119,001,431 |

Notes

1. Assumes a 7.00% return net of investment management fees in the PPLI separate account.
2. Assumes a hypothetical combined effective state and federal income tax rate on taxable earnings of 40%.
3. The policy is designed as a non-Modified Endowment Contract (non-MEC) under current tax law.
4. Under current tax law, if the policy is fully surrendered, all investment gains in excess of the policy owner's basis are taxed to the policy owner as ordinary income in the year the policy is fully surrendered. Withdrawals or loans are tax-free to the policy owner.
5. Assumes federal DAC taxes are charged against each premium deposit.
6. These calculations make assumptions as to future investment returns, mortality costs, and administrative expenses that are not guaranteed. Actual results may be higher or lower. The contents of this report are provided strictly for informational purposes. It does not constitute an offer by Giordani Fitte Grossman & Ripp LLP, or any other party to you or to any other person to acquire a life insurance policy.

Taxable Investment vs. PPLI

Four Annual Investments of \$2,500,000 – Non-MEC
Male, Age 45, Preferred Non-Smoker



Taxable Investment vs. PPLI

Single Investment of \$10,000,000 – MEC Male, Age 45, Preferred Non-Smoker

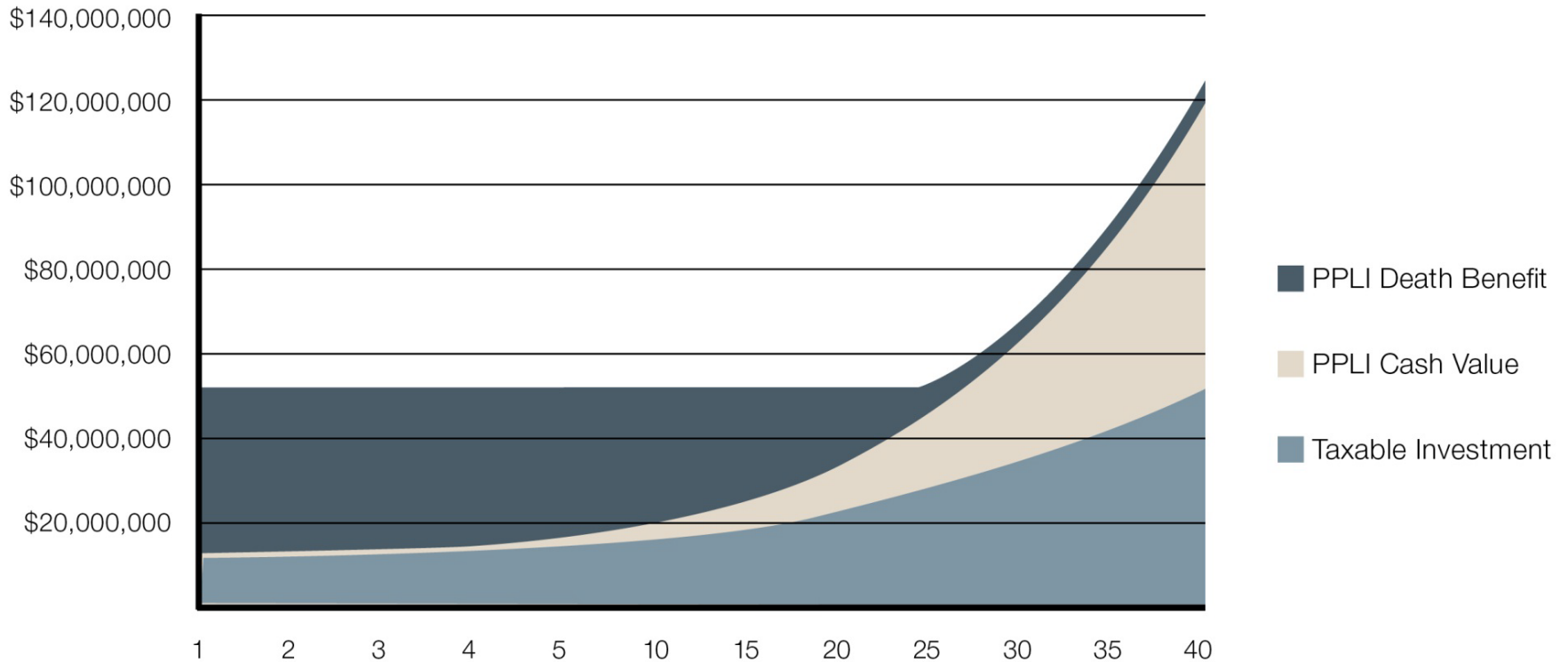
| Year | Age | Deposit | GROSS RETURN | | | TAXABLE INVESTMENT | | | PRIVATE PLACEMENT LIFE INSURANCE | | |
|------|-----|--------------|---------------|---------------|-------------------------|--------------------|-------------------------|----------|----------------------------------|-------------------------|---------------|
| | | | Annual Return | Account Value | Internal Rate of Return | Account Value | Internal Rate of Return | Tax Cost | Subaccount Value | Internal Rate of Return | Death Benefit |
| 1 | 45 | \$10,000,000 | 7.00% | \$10,700,000 | 7.00% | \$10,420,000 | 4.20% | 2.80% | \$10,546,774 | 5.47% | \$51,983,533 |
| 2 | 46 | – | 7.00% | 11,449,000 | 7.00% | 10,857,640 | 4.20% | 2.80% | 11,196,982 | 5.82% | 51,983,533 |
| 3 | 47 | – | 7.00% | 12,250,430 | 7.00% | 11,313,661 | 4.20% | 2.80% | 11,884,305 | 5.92% | 51,983,533 |
| 4 | 48 | – | 7.00% | 13,107,960 | 7.00% | 11,788,835 | 4.20% | 2.80% | 12,615,660 | 5.98% | 51,983,533 |
| 5 | 49 | – | 7.00% | 14,025,517 | 7.00% | 12,283,966 | 4.20% | 2.80% | 13,387,548 | 6.01% | 51,983,533 |
| 10 | 54 | - | 7.00% | 19,671,514 | 7.00% | 15,089,581 | 4.20% | 2.80% | 17,918,659 | 6.01% | 51,983,533 |
| 20 | 64 | – | 7.00% | 38,696,845 | 7.00% | 22,769,546 | 4.20% | 2.80% | 32,483,137 | 6.07% | 51,983,533 |
| 30 | 74 | – | 7.00% | 76,122,550 | 7.00% | 34,358,292 | 4.20% | 2.80% | 61,532,471 | 6.24% | 65,839,744 |
| 40 | 84 | – | 7.00% | 149,744,578 | 7.00% | 51,845,224 | 4.20% | 2.80% | 118,075,662 | 6.37% | 123,979,445 |

Notes

1. Assumes a 7.00% return net of investment management fees in the PPLI separate account.
2. Assumes a hypothetical combined state and federal income tax rate on taxable earnings of 40%.
3. The policy is designed as a Modified Endowment Contract (MEC) under current tax law.
4. Under current tax law, if the policy is fully surrendered, all investment gains in excess of the policy owner's basis are taxed to the policy owner as ordinary income in the year the policy is fully surrendered. In addition, withdrawals or loans up to basis are taxed at ordinary income rates and there is a 10% penalty on withdrawals made before age 59 1/2.
5. Assumes federal DAC taxes are charged against the premium deposit.
6. These calculations make assumptions as to future investment returns, mortality costs, and administrative expenses that are not guaranteed. Actual results may be higher or lower. The contents of this report are provided strictly for informational purposes. It does not constitute an offer by Giordani Baker Grossman & Ripp LLP, or any other party to you or to any other person to acquire a life insurance policy.

Taxable Investment vs. PPLI

Single Investment of \$10,000,000 – MEC
Male, Age 45, Preferred Non-Smoker



Purchasing PPLI Internationally

- Premium tax savings (*no state premium tax and, in some cases, lower DAC tax*)
- Greater investment management flexibility than domestically
- Superior asset protection
- Opportunity for broker-less transaction (*lower fees*)
- Foreign ownership structure required
- International underwriting and application required
- Sales, solicitation, or negotiation of international life insurance products in U.S. is prohibited

Investment Account Security

- Separate investment “sub-account(s)” are the account(s) in which insurance cash values are held and invested
- Sub-accounts are fully protected from the insurance company’s creditors under U.S. state law (*similar legislation exists in Bermuda, Cayman Islands, Bahamas, and Guernsey, etc.*)
- Premium payments can and should be paid directly into carrier’s sub-account(s)
- Death benefit proceeds from reinsurance companies can be paid into and then out of sub-account(s) for international policies

Pre-Death Exit Strategy

- Policyowner typically can withdraw and/or borrow up to 90% of the cash value of the policy without “surrendering” the policy in the case of a non-MEC
- Surrendering the policy triggers income tax on the earnings of the policy at ordinary income tax rates
- Death benefit can be reduced typically after year eight, subject to rules regarding Modified Endowment Contracts and definition of life insurance testing, to reduce insurance policy costs and allow for more efficient investment growth

Underwriting

- Medical
 - Full medical exam required, including stress EKG
 - Full health history disclosure
- Financial
 - Net worth and future estate tax liability must justify insurance coverage
 - Full financial disclosure
- Confidentiality Issues

The Process: What to Expect

CLIENT

Attorney/ Advisor

- Provides comprehensive review and understanding of entire transaction
- Advises on policy ownership structure
- Legal and tax expert
- Negotiates with counterparties on purchaser's behalf

Investment Manager(s)

- Executes investment management agreement with insurance company
- Manages policy assets on behalf of insurance company
- Certifies 817(h) compliance
- Reports values to carrier

Investment Consultant

- Advises policy owner about investment management choices
- Coordinates insurance with overall asset allocation

Insurance Company

- Provides investment options
- Underwrites the policy
- Issues policy
- Reinsures excess risk
- Reports policy values to policy owner

Insurance Professional *(if necessary)*

- Completes application
- Leads client through underwriting process
- Coordinates case design and illustrations

Uses of PPLI in Tax and Estate Planning

- Income tax protection of portfolio earnings
 - Individual, grantor trust, or single owner entity purchases policy
- Asset protection structure
 - Individual establishes foreign “asset protection” trust then trustee purchases policy as vehicle for trust’s liquid asset investments
- Transfer Tax Exempt Trust structure
 - Trustee of dynasty or similar exempt asset trust purchases policy as tax efficient vehicle for trust’s liquid asset investments
- FLP (*or Family LLC*) structure
 - Family limited partnership purchases policy as vehicle for partnership’s liquid asset investments
 - Income tax protection and leverage of discounted or potentially discountable assets’ earnings

Uses of PPLI in Tax and Estate Planning *(continued)*

- Irrevocable Life Insurance Trust (ILIT) structure
 - Income tax protection of earnings on assets transferred gift-tax free
 - Possible use for lifetime exclusion amount and/or annual “Crummey” gifts
 - If exclusion amounts are insufficient, senior generation can lend premium to ILIT (grantor trust) for the benefit of junior generation then trustee of ILIT can purchase policy as vehicle for trust’s investments (split-dollar loan)
- Income tax protection of distributions to U.S. beneficiaries from Foreign Non-Grantor Trust (“FNGT”)
 - Trustee of FNGT purchases policy as vehicle for trust’s investments
- Income tax protection of non-U.S. person’s assets while temporarily residing in the U.S.
 - Trust created by non-U.S. person before establishing residence in U.S. purchases variable annuity or life insurance policy as vehicle for liquid investments



Private Placement Life Insurance

2301 S. CAPITAL OF TEXAS HWY, BUILDING K | AUSTIN, TEXAS 78746

phone 512.767.7100 | *fax* 512.767.7101 | GFGRLAW.COM