John Hancock

Success Story

Advanced Markets

Planning in Action

Maximizing death benefit — leveraging sale to defective trust with commercial premium financing

Case in point

A high-net-worth couple was working with their insurance agent and attorney on their estate planning. The goal was to mitigate estate taxes and minimize any gifting/gift taxes. The agent contacted John Hancock's Advanced Markets team to discuss using life insurance to meet these clients' goals.

Designing a case

The Advanced Markets Consultant (AMC) had several factors to consider:

- The attorney wanted to move some of the clients' assets out of their taxable estate and into an irrevocable trust.
- The agent estimated that the clients' approximate estate tax liability at life expectancy would be about $50M (after taking into account their charitable bequests and estate planning). Therefore, he wanted to use a $30M second-to-die life insurance policy to provide a source of funds to help pay some of the estate taxes. In addition, because the clients are not very liquid and interest rates are currently low, the agent wanted to look at financing options and techniques.
- Should the husband predeceases the wife, the couple wanted to provide $10M of liquidity for the wife to use for her living expenses as well as potentially create another source of funds to help pay any eventual estate taxes. The clients also stated that they wanted to retain control of a majority of their real estate holdings, but would be willing to use $10M of those shares (growing at 5% and generating 6% income annually) for planning purposes. With these factors in mind, the AMC designed a plan incorporating two different financing techniques to fund the two life insurance policies.
  - The first was selling $10M worth of shares (at a 25% discount) of the clients' real estate holdings to an Intentionally Defective Grantor Trust (IDGT) in return for a note (at current long-term applicable federal rates (AFR)). The income generated on those shares, inside the trust, will then be used to pay $348K annual premiums on a $30M second-to-die life insurance policy (Protection Survivorship UL) and pay the $88K interest payments back to the grantor (husband and wife). This technique is often called "Sale to a Grantor Trust" (SAGT). The real estate shares were sold to the trust on a 30-year note, with the plan of using the excess cash flow in the trust to repay the note. A "seed"

Client profile

The clients' net worth consists almost entirely of high-growth, high-income-producing real estate. The husband is primarily responsible for the day-to-day business operations and wants to be sure his wife has adequate funds to continue her current lifestyle if he passes before her. They also want to leave a significant legacy for their heirs, while bequeathing a substantial amount to charity.

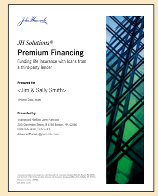
Fact finding

- Husband is 64, Standard Plus, and wife is 62, Preferred
- The clients have net worth of approximately $160M

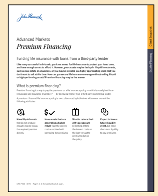
gift, consisting of a combination of cash and real estate totaling $1M, was also made to the trust to help ensure the transactions will be treated as a legitimate sale and provide the trust with the liquidity to pay the first year life insurance premium.

– The second financing technique, to be used on a $10M single-life policy on the husband, uses commercial premium financing. The trust will acquire a loan from a commercial lender each year to pay the $333K 10-pay planned premium. The AMC designed the premium-financing case using a Protection IUL policy with a level death benefit, using the excess income being generated in the IDGT (above and beyond the income being used for the SAGT planning) to pay the loan interest each year, and to repay the loan balance in full in year 11. This design also provides a great deal of flexibility because the $10M death benefit proceeds could be used to repay some or all of the SAGT note, which would be paid to the wife (if she's the second to die) to help with her living expenses and/or to the estate.

Resources



JH Solutions Premium Finance



Premium finance client snapshot

JH Solutions Sale to a Grantor Trust

Why it works

Using these two financing techniques, the clients were able purchase two life insurance policies outside of their taxable estate by using the cash flow from the asset in the IDGT to pay both premium and service loan interest. The design allowed them to transfer $10M of high income-producing real estate shares out of the estate and lock in the low July AFR rate of 1.17%, minimizing the amount coming back into the taxable estate. The husband's commercially financed policy was also able to take advantage of low lending costs. The death benefit proceeds can provide living expenses to the wife (if she is predeceased by her husband) and/or can repay the SAGT note (back to wife) or be used to help with estate taxes, etc.

Conclusion

The current low interest rate environment, for both commercial loans and private sales/loans, provides opportunities for clients to purchase life insurance policies in their trusts for minimized gifting costs. In this case, the clients were able to take advantage of the low AFR rates and sell shares of their real estate to the trust and get an "estate freeze" on those shares, because the growth and income happens in the trust. They were also able to take advantage of low lending rates to purchase a policy the husband. In short, combining these two types of financing techniques provided this couple with the assurance that the wife will have liquidity when needed and that there will be a source of funds to help pay estate taxes when the time comes.

Call Advanced Markets at *888-266-7498, option 3* to speak with an Advanced Markets Consultant, or email *advancedmarkets@jhancock.com*