



Reducing Estate Tax Uncertainty with Private Split Dollar

Do you have clients who are hesitant to purchase life insurance in an irrevocable life insurance trust (ILIT) because of the uncertainty of the estate tax law? Are they concerned that an ILIT might restrict them from using the policy cash values if the need arises? Or, are they worried about premium expense resulting in gift tax costs? If so, you may be able to overcome their hesitancy to purchase life insurance with the following idea.

Facts: The clients have been talking to their advisers about estate and retirement planning. Most of their estate consists of a closely held business and illiquid real estate. Their goals are to accumulate sufficient assets to support their retirement lifestyle and then pass their estate to their heirs at death. They have been advised of the benefits of paying estate taxes with trust-owned life insurance; however, they are reluctant to proceed because of the possibility that the increasing estate tax credit may shelter their assets from estate taxes, making the life insurance unnecessary. Furthermore, they are concerned about committing funds for insurance premiums fearing that they may need them later.

A private spousal split dollar arrangement may help fund their estate tax obligation and allow them to retain access to the life insurance cash values while providing flexibility with respect to estate tax law changes. Here is how the concept works.

Solution: The private spousal split dollar arrangement is a form of non-equity collateral assignment split dollar that was favorably reviewed by the IRS in private letter ruling (PLR) 9636033 in 1996.

In a private spousal split dollar arrangement, the insured spouse first establishes an ILIT and seeds it with a cash gift using separate funds. The non-insured spouse and children are named as beneficiaries of the trust.

An independent trustee then purchases a life insurance policy and enters into a non-equity collateral assignment split dollar agreement with the non-insured spouse. Regardless of when the split dollar arrangement is entered into, the non-equity collateral assignment structure is taxed under the economic benefit tax regime.¹ Under the terms of the split dollar agreement, the trustee pays the portion of the premium equal to

¹ Equity collateral assignment split dollar arrangements entered into after 9/17/03 (the publication of final regulations), are taxed under the loan regime. In contrast to taxing the value of the life insurance protection, under the loan regime the uncharged interest on the premium advances is a taxable gift to the trust.

This training material has been prepared to assist our licensed financial professionals. It is designed to provide general information in regard to the subject matter covered. It should be used with the understanding that Prudential is not rendering legal, accounting or tax advice. Such services should be provided by the client's own advisors.

FOR INTERNAL USE ONLY. NOT FOR USE WITH THE PUBLIC.

the economic benefit amount using the funds gifted to the trust by the grantor/insured. Under this structure, the economic benefit is the value of the life insurance protection.² The noninsured spouse advances the balance of the premiums (from separate funds) in exchange for an interest in the policy equal to its total cash value. This portion of the premium payment is not a gift to the trust.

During the term of the split dollar arrangement, the trustee can access policy cash values through policy withdrawals or loans, which can be used for the benefit of the noninsured spouse.³ Thus, the policy values are available to help supplement the couple's income. In addition, the couple will have the benefit of permanent life insurance free from the federal estate tax.

If there is a change in the clients' financial situation or subsequent changes in estate tax law diminish the need for estate liquidity, the split dollar arrangement can be terminated and the policy ownership transferred to the noninsured spouse.

Product Choice: PruLife Custom Premier VUL II is well suited to this concept. While the most important reason to purchase this product is for the death benefit, its competitive combination of the mortality costs, the design of the policy loads and fees, and the preferred loan interest rate available after policy year 10, gives it potential for competitive cash value accumulation.³ In addition, the client has the option of selecting from a wide variety of variable investment options, plus a fixed-rate option. Finally, adding the Target Term Rider gives your client the flexibility to enhance cash value accumulation.

CHART IS ATTACHED

² The life insurance protection is calculated using either the rules in Notice 2002-8 or the rules in other IRS guidance, as applicable.

³ Life insurance policy cash values are accessed through withdrawals and/or policy loans. Loans and withdrawals cause a reduction in cash values and death benefit; may affect any death benefit guarantees; and may have tax consequences.

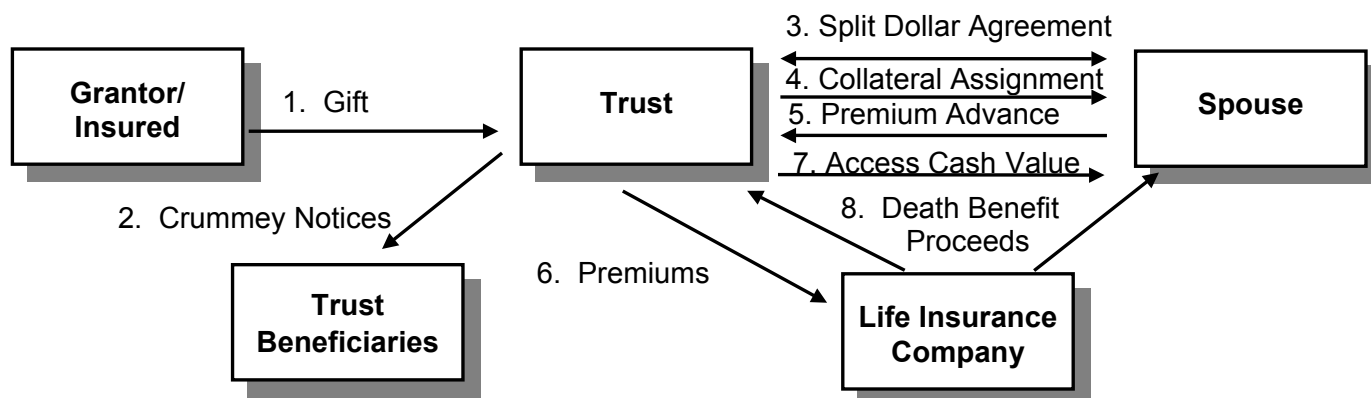
PruLife Custom Premier II is issued by Pruco Life Insurance Company in all states except New York, where it is issued by Pruco Life Insurance Company of New Jersey, and offered through Pruco Securities, LLC (member SIPC), 751 Broad Street, Newark NJ 07102. All are Prudential Financial Companies, and each is solely responsible for its own financial conditions and contractual obligations. All guarantees are based on the claims-paying ability of the insurer. For more information on PruLife Custom Premier, including charges and expenses, see the prospectus.

QUESTIONS? CALL ADVANCED MARKETING

©2006 The Prudential Insurance Company of America
751 Broad Street, Newark, NJ 07102-3777
IFS-A063473 Ed. 06/06 Exp. 08/08

Prudential  **Financial**

Structure of a Non-Equity Collateral Assignment Private Spousal Split Dollar Arrangement



1. Grantor/insured establishes an irrevocable life insurance trust (ILIT) and “seeds” the trust with a gift from his or her separate assets and not subject to the split dollar agreement.
2. The trustee of the ILIT makes the gift available to the trust beneficiaries pursuant to the Crummey withdrawal provision in the trust document. This qualifies the gift to the ILIT for gift tax annual exclusion treatment.
3. The trustee applies for an individual life insurance policy on the grantor’s life. The trustee enters into a *non-equity collateral assignment split dollar agreement* with the insured’s spouse where the trustee pays an amount equal to the economic benefit and the insured’s spouse pays the balance of the premium.⁴
4. The trustee executes a collateral assignment of the policy in favor of the spouse for an amount equal to the total policy cash surrender value.
5. The insured’s spouse advances premium amounts in excess of the economic benefit to the trust from his or her separate assets. This portion of the premium is not considered a gift.
6. The trustee pays the life insurance policy premiums to the insurance company, using dollars advanced by the insured’s spouse, and by contributing trust funds (from the seed money) equal to the economic benefit cost.⁵
7. Under the terms of the split dollar agreement and collateral assignment, the spouse controls the access to the policy cash value. This allows the spouse to use the cash value for the benefit of the family if necessary.⁶ (In many situations where an ILIT owns a life insurance policy the cash value is not accessible to the grantor or his or her family.)
8. At the insured’s death, the insurance company pays the death proceeds to the trust and the spouse /family members according to the terms of the split dollar agreement and the collateral assignment.

⁴ If the split dollar arrangement is structured as an equity collateral assignment, where the interest of the insured spouse is limited to premiums paid, different tax consequences may result.

⁵ The economic benefit under these facts is the cost of the life insurance protection and is calculated using either the rules in Notice 2002-8 or the rules in other IRS guidance, as applicable.

⁶ Life insurance policy cash values are accessed through withdrawals and/or policy loans. Loans are at interest. Loans and withdrawals cause a reduction in policy cash values and death benefits, may affect any death benefit guarantee against lapse, and may have tax consequences.