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BUILDING, PROTECTING AND PERPETUATING FAMILY WEALTH

Generational Asset Protection Strategy

The strategy is to transfer large amounts of wealth from Generation 1 to later generations by reducing the value of Generation 1's estate. This strategy is particularly effective where Generation 1 is uninsurable, lacks insurance capacity, or desires enhanced economic results. In larger estates it may be the only remaining strategy to achieve estate tax reduction.

In addition, this strategy is often employed by those who have highly taxable estates, but for a multitude of reasons do not want to gift or give up control over their assets. This strategy does not require the gifting or loss of control over estate assets to reduce the estate tax.

Generational Asset Protection is designed as a method to reduce the value of the estate of Generation 1 through valuation discounting. Although it does take advantage of the split dollar technique to the extent permitted under current IRS guidelines, it should not be confused with traditional split dollar planning.

In simplified form, the Generational Asset Protection tax strategy works as follows:

Generation 1 provides a loan to Generation 2 for the purpose of acquiring life insurance which will be held in trust for the beneficiaries of Generation 2. The life expectancy of Generation 2 should be dramatically greater than that of Generation 1.

The transaction is structured as a non-equity split dollar or loan regime arrangement, where Generation 1 has a restrictive right to be paid back for their loan from the accumulated cash values and or the death benefit proceeds.

Typically the life insurance policy acquired is designed to be a Non-Modified endowment contract ("NON-MEC") and any policy gain distributed will therefore be tax-free.

To facilitate the loan from Generation 1 these transactions are often structured using premium finance so that Generation 1 can retain their capital. The life insurance funded from the loan may be completed over one or more years, and the loan interest may be paid, partially paid or deferred (capitalized).

In financing this arrangement the life insurance contracts are required to minimize policy cost and maximize the accumulated policy cash values, so that the life insurance contract becomes the primary collateral.

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Subsequently an appraisal is obtained to value the "right of receipt" held by Generation 1. The appraised value takes into consideration the present value of the loan made, and other business and economic factors, usually resulting in a discounted value of 40% to 90%.

It is the discounted value of the "right of receipt" which creates the reduction in the value of the gross taxable estate for Generation 1. The "right of receipt" is ultimately gifted from the estate into Trust for the benefit of Generation 2. The split dollar arrangement remains in place and the life insurance on Generation 2 continues to be held in Trust.

The life insurance on Generation 2 is evaluated after several years following the gifting of the "right of receipt" to determine whether or not it will remain in force. Factors that would be considered include and may not be limited to: Generation 1's current estate tax exposure and the current health and estate tax exposure of Generation 2.

In the event the transaction is terminated prematurely and the life insurance policy is surrendered (within five years), the life insurance accumulated cash values will have increased but on an after tax basis will usually be insufficient to repay the bank loan when interest has been capitalized. The after tax result will be a cost usually in the 5% to 15% range of the estate tax benefit.

Under current plan design the life insurance when held longer than eight years will under reasonable return assumptions accumulate sufficiently on an after tax basis to repay the bank loan (and loan interest if it has been capitalized), and result in a net after tax gain. The transaction would have resulted in no cost for the estate tax benefit.

There are multiple tax opinions which have been written by several extremely well known and recognized estate tax attorneys on the Generational Split Dollar strategy. The strategy has been employed by a number of national accounting and law firms over the past ten years.

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