

Loan-Based Private Split Dollar

Preface

Loan-based private split dollar involves a series of promissory notes between a Lender -- usually a parent or grandparent -- and an irrevocable trust formed on behalf of children or grandchildren. It is designed to be in compliance with the Final Split Dollar Regulations issued in September 2003 (68 FR 54336).

Promissory Notes: The loans associated with the arrangement are evidenced by a series of promissory notes between the Lender and the trust, and the life insurance policy is assigned as collateral security for the loans. The loans are term loans, i.e., they are due at the end of a specific period of years; however, the promissory note calls for the acceleration of repayment should the insured die prior to the date of scheduled loan repayments.

Loan Interest: The interest rate for the life of each loan is set at least to the long-term rate in effect at the beginning of the loan under IRC Sections 7872(f)(2)(A) and 1274(d) (often referred to as the "Applicable Federal Rate" or "AFR"). As an additional benefit in some arrangements, the employer will help offset the executive's loan interest payments via a bonus.

If no interest or an inadequate rate of interest is charged on a loan, the IRS recharacterizes the loan into an "arms-length" transaction and imputes an interest rate that is deemed to have been received by the lender and paid by the borrower. The rate is published monthly and is determined by the length of the loan transaction, i.e., either the short-term rate (3 years or less), the mid-term rate (over 3 years but not over 9 years), or the long-term rate (over 9 years).

So long as the loan interest rate is equal to or exceeds the Applicable Federal Rate, no interest is imputed by the IRS on the transaction. For illustrative purposes, the entire series of premium loans illustrated in the accompanying material reflects a constant 5.21% interest rate, the long-term AFR in effect for the month in which this report is written (August 2004). The loan interest rate for each new loan will likely be different, and each future loan must bear interest equal to or greater than the AFR in effect during the month the new loan is executed. Each new loan should be evidenced by its own promissory note as well.

There are four ways to deal with unknown future loan interest rates:

1. Accept the risk: If the loan interest is paid in cash, gifts to the trust for its loan interest are immediately returned in the form of non-taxable interest, so it makes little difference in most cases if the loan interest varies.
2. Accrue additional loan interest: If the loan interest rate increases, the trust could be allowed to accrue the additional loan interest. Alternatively, the trustee may be able to withdraw funds from the policy to make up the difference in the loan interest due.

3. Renegotiate the loans: Wait until a time when the rate dips and recast the series of promissory notes into a new note at the reduced rate. For a detailed analysis of this strategy, see the report entitled "Renegotiating the Applicable Federal Rate".
4. Consolidate all loans at the inception of the arrangement: In this case, the loaned funds in excess of those needed to pay the policy's initial premium should be reserved by the executive to pay the remaining stream of premiums as they fall due. The employer may wish to consider requiring some form of custodianship for the reserved funds to be certain they are used for the intended purpose.

The accompanying calculations assume the trust is a so-called "intentionally defective" grantor trust, and additional gifts to the trust are usually scheduled to offset any loan interest due by the trust. The Lender is assumed to be the grantor of the trust and, due to grantor trust rules, there is no income tax due by the Lender on such loan interest received, i.e., the Lender and the trust are a single income tax entity. (IRC Section 671 and 675, IRS Reg. 1.671-2(c) and Rev. Rul. 85-13.) Thus, if gifts for loan interest are made, they are returned as non-taxable loan interest.

Annual Gift Exclusions and Lifetime Gift Exemptions: The loaned funds should not apply against the Lender's (and his/her spouse's) lifetime gift exemption or annual gift exclusions, significantly greater amounts than usual can be allocated to the trust without incurring gift or estate taxes.

Taxation At Death: The life insurance payable to the trust should be free of all estate transfer taxes as the presence of the loans to the trust should not contaminate the estate tax free nature of the life insurance death benefit (PLR 9809032). The promissory notes are repayable by the trust at the end of the term of years specified in the promissory note or at the death of the Lender, whichever occurs first, and repayment proceeds triggered by the death of the Lender will be subject to estate settlement costs in the estate of the Lender.

If there is any accrued loan interest included in the repayment proceeds, there should be no income tax consequences to the Lender's estate on the loan interest component since, as indicated above, the Lender and the trust are a single income tax entity.

Policy Loans: Assuming the terms of the trust authorize borrowing on the policy, the trustee of the trust can borrow policy cash values in excess of those that collateralize the promissory notes and any accrued interest and, if deemed appropriate by the trustee, policy loans can be used to provide cash flow to trust beneficiaries. The trustee can also use policy loans for promissory note repayments or loan interest payments.

Notes

Policy loans reduce cash values and death benefits, and the lapse of a policy with loans could result in significant tax ramifications to the policy owner.

Be sure to consult with your own tax attorney and accountant before entering into this or any other arrangement involving tax, legal, and economic considerations.

Loan-Based Private Split Dollar

Supplemental Report: Duration of Loans

The accompanying illustrations reflect loans that may remain in effect for many years. Most loans illustrated are assumed to be long-term loans (over 9 years) bearing a loan interest rate equal to or greater than the Applicable Federal Rate of 5.21% for August 2004. Other Applicable Federal Rates in effect for August 2004 are:

Mid-term loans (over 3 years but not over 9): 4.00%;

Short-term loans (3 years or less): 2.37%;

Demand loans: 2.37%.

The demand loan rate changes monthly -- an unhappy condition for a loan expected to remain in effect for many years. A so-called "blended" rate that is stable for one year at a time can be used for demand loans. The 2004 blended rate for demand loans is 1.99%, and the blended rate for 2005 will not be announced until late June 2005.

Stability of loan interest is an important component of any arrangement involving loans. A dramatic rise in loan interest rates at the maturity of a demand, short-term or mid-term loan may result in less-than-acceptable loan interest rates when the loan is renewed. When you are dealing with a financial arrangement of many years, long-term loans produce more stable interest rates that can be renegotiated downward should rates decline, but are capped at rates that are known as each loan is made. For an example of renegotiating loan interest downward, see the report entitled "Renegotiating the Applicable Federal Rate".

Due to the relative stability of the long-term Applicable Federal Rate coupled with the ability to renegotiate it downward, you may wish to establish your arrangement using long-term loans.

Loan-Based Private Split Dollar Funded With Variable Survivor Life (VSL)

Illustration of Values of The Policy Funding Loan-Based Private Split Dollar

Presented By: [Licensed User's Name Appears Here]
Date: 08/17/2004
Values Page: 1

Lender and Trust Grantor: Jerry Grant
Borrower and Policy Owner: Grant Family Trust
Insureds: Jerry Grant/Janet Grant

		M/F Age	VSL Interest Rate	Initial Premium	Initial Policy Death Benefit		
		65/60	10.00%	300,000	10,000,000		
Year	Ages	(1) Policy Premium	(2) Pre-Tax Policy Cash Flow	(3) Year End Accum Value*	(4) Year End Cash Value*	(5) Death Benefit	
1	65/60	300,000	0	224,448	0	10,224,450	
2	66/61	300,000	0	549,531	283,531	10,549,530	
3	67/62	300,000	0	901,372	635,372	10,901,370	
4	68/63	300,000	0	1,282,245	1,016,245	11,282,250	
5	69/64	300,000	0	1,693,993	1,427,992	11,693,990	
6	70/65	0	0	1,829,140	1,576,440	11,829,140	
7	71/66	0	0	1,970,151	1,730,751	11,970,150	
8	72/67	0	0	2,122,024	1,895,924	12,122,020	
9	73/68	0	0	2,282,809	2,070,009	12,282,810	
10	74/69	0	0	2,452,513	2,253,013	12,452,510	
11	75/70	0	0	2,628,522	2,448,972	12,628,520	
12	76/71	0	0	2,811,623	2,652,023	12,811,620	
13	77/72	0	0	2,996,923	2,857,273	12,996,920	
14	78/73	0	0	3,183,361	3,063,661	13,183,360	
15	79/74	0	0	3,377,031	3,277,281	13,377,030	
16	80/75	0	0	3,578,549	3,498,749	13,578,550	
17	81/76	0	0	3,786,087	3,726,237	13,786,090	
20	84/79	0	0	4,396,615	4,396,614	14,396,610	
25	89/84	0	0	5,172,231	5,172,230	15,172,230	
30	94/89	0	0	4,523,176	4,523,176	14,523,180	
		1,500,000	0				

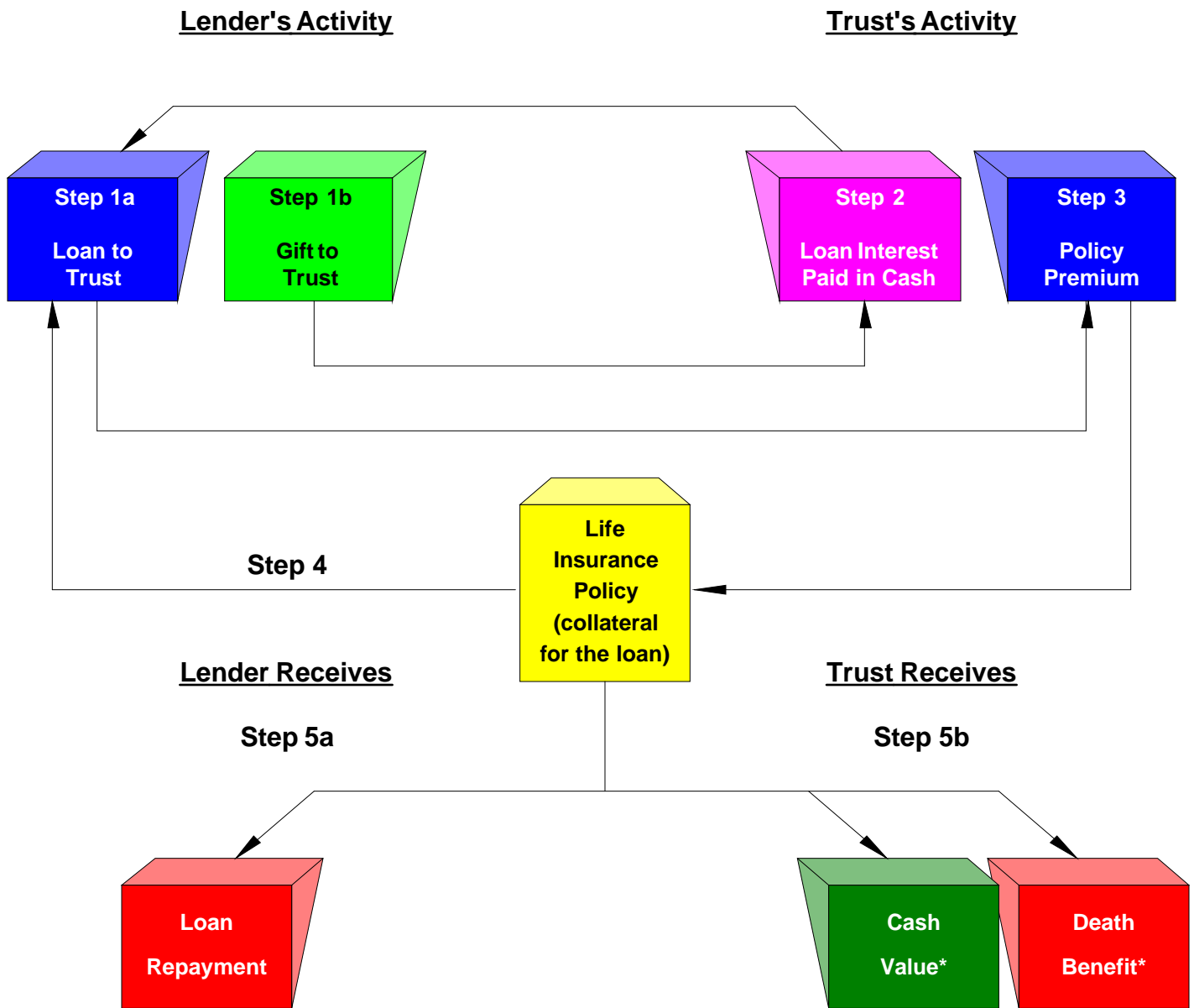
*This is an example of an InsMark "supplemental" illustration for variable survivor universal life. For an actual presentation, this footnote will refer to an accompanying "basic" illustration from a specific life insurance company and a prospectus.

Loan-Based Private Split Dollar Funded With Variable Survivor Life (VSL)

Presented By: [Licensed User's Name Appears Here]
Date: 08/17/2004

Lender and Trust Grantor: Jerry Grant
Borrower and Policy Owner: Grant Family Trust
Insureds: Jerry Grant/Janet Grant

Flow Chart Analysis



*Net of loan repayment.

Summary

Loan-Based Private Split Dollar Funded With Variable Survivor Life (VSL)

Presented By: [Licensed User's Name Appears Here]
Date: 08/17/2004
Summary Page: 1

Lender and Trust Grantor: Jerry Grant
Borrower and Policy Owner: Grant Family Trust
Insureds: Jerry Grant/Janet Grant

M/F	VSL	Initial Policy	Assumed Long-Term AFR
Age	Interest Rate	Death Benefit	for All Years Illustrated
65/60	10.00%	10,000,000	5.21%

		Gift and Loan Summary			Analysis of the Collateral		
		(1)	(2)	(3)	(4)	(5)	(6)
					Variable Survivor Life (VSL)		
Year	Ages	Gift to Trust for Premium	Loan to Trust for Premium	Year End Balance of Loan	Year End Accum Value*	Year End Cash Value*	Year End Death Benefit
1	65/60	0	300,000	300,000	224,448	0	10,224,450
2	66/61	0	300,000	600,000	549,531	283,531	10,549,530
3	67/62	0	300,000	900,000	901,372	635,372	10,901,370
4	68/63	0	300,000	1,200,000	1,282,245	1,016,245	11,282,250
5	69/64	0	300,000	1,500,000	1,693,993	1,427,992	11,693,990
6	70/65	0	0	1,500,000	1,829,140	1,576,440	11,829,140
7	71/66	0	0	1,500,000	1,970,151	1,730,751	11,970,150
8	72/67	0	0	1,500,000	2,122,024	1,895,924	12,122,020
9	73/68	0	0	1,500,000	2,282,809	2,070,009	12,282,810
10	74/69	0	0	1,500,000	2,452,513	2,253,013	12,452,510
11	75/70	0	0	1,500,000	2,628,522	2,448,972	12,628,520
12	76/71	0	0	1,500,000	2,811,623	2,652,023	12,811,620
13	77/72	0	0	1,500,000	2,996,923	2,857,273	12,996,920
14	78/73	0	0	1,500,000	3,183,361	3,063,661	13,183,360
15	79/74	0	0	1,500,000	3,377,031	3,277,281	13,377,030
16	80/75	0	0	1,500,000	3,578,549	3,498,749	13,578,550
17	81/76	0	0	1,500,000	3,786,087	3,726,237	13,786,090
20	84/79	0	0	1,500,000	4,396,615	4,396,614	14,396,610
25	89/84	0	0	1,500,000	5,172,231	5,172,230	15,172,230
30	94/89	0	0	1,500,000	4,523,176	4,523,176	14,523,180
		0	1,500,000				

30 Year Analysis

	Living Values†	Death Benefit
VSL:	4,523,176	14,523,180
Loan Repayment Due:	1,500,000	1,500,000
Value to Policy Owner:	3,023,176	13,023,180

†Cash value less loans due Lender.

*This is an example of an InsMark "supplemental" illustration for variable survivor universal life. For an actual presentation, this footnote will refer to an accompanying "basic" illustration from a specific life insurance company and a prospectus.

Promissory Note Analysis

Loan-Based Private Split Dollar Funded With Variable Survivor Life (VSL)

Presented By: [Licensed User's Name Appears Here]
Date: 08/17/2004
Promissory Note Analysis Page: 1

Lender and Trust Grantor: Jerry Grant
Borrower and Policy Owner: Grant Family Trust
Insureds: Jerry Grant/Janet Grant

		M/F Age 65/60	Assumed Long-Term AFR for All Years Illustrated 5.21%	Promissory Note Interest Rate 5.21%		
		(1)	(2)	(3)	(4)	
Year	Ages	Loan to Trust for Premium	Loan Interest Due	Gift to Trust for Loan Interest	Year End Balance of Loan	
1	65/60	300,000	15,630	15,630	300,000	
2	66/61	300,000	31,260	31,260	600,000	
3	67/62	300,000	46,890	46,890	900,000	
4	68/63	300,000	62,520	62,520	1,200,000	
5	69/64	300,000	78,150	78,150	1,500,000	
6	70/65	0	78,150	78,150	1,500,000	
7	71/66	0	78,150	78,150	1,500,000	
8	72/67	0	78,150	78,150	1,500,000	
9	73/68	0	78,150	78,150	1,500,000	
10	74/69	0	78,150	78,150	1,500,000	
11	75/70	0	78,150	78,150	1,500,000	
12	76/71	0	78,150	78,150	1,500,000	
13	77/72	0	78,150	78,150	1,500,000	
14	78/73	0	78,150	78,150	1,500,000	
15	79/74	0	78,150	78,150	1,500,000	
16	80/75	0	78,150	78,150	1,500,000	
17	81/76	0	78,150	78,150	1,500,000	
20	84/79	0	78,150	78,150	1,500,000	
25	89/84	0	78,150	78,150	1,500,000	
30	94/89	0	78,150	78,150	1,500,000	
		1,500,000	2,188,200	2,188,200		

See the accompanying supplemental report entitled "Loan-Based Private Split Dollar (Preface)" for remarks regarding loan interest rates used in this illustration.

The promissory note between the parties is presumed to be secured by a collateral assignment of the policy.

The promissory note associated with this plan is due in 30 years or at the prior death of the insureds.

Gift Analysis

Loan-Based Private Split Dollar Funded With Variable Survivor Life (VSL)

Presented By: [Licensed User's Name Appears Here]
Date: 08/17/2004
Gift Analysis Page: 1

Lender and Trust Grantor: Jerry Grant
Borrower and Policy Owner: Grant Family Trust
Insureds: Jerry Grant/Janet Grant

Year	Ages	(1) Lifetime Gift Exemption	M/F Age 65/60 (2) Annual Gift Exclusion Indexed @ 3.00%	Annual Gift Exclusions 8 (3) Maximum Tax Free Gifts Available (1) + (2)	Beginning Lifetime Gift Exemption 2,000,000 (4) Gift to Trust for Premium	(5) Gift to Trust for Loan Interest	(6) Total Gift to Trust (4) + (5)	(7) Remaining Tax Free Gifts Available (3) - (6)
1	65/60	2,000,000	88,000	2,088,000	0	15,630	15,630	2,072,370
2	66/61	2,000,000	88,000	2,088,000	0	31,260	31,260	2,056,740
3	67/62	2,000,000	96,000	2,096,000	0	46,890	46,890	2,049,110
4	68/63	2,000,000	96,000	2,096,000	0	62,520	62,520	2,033,480
5	69/64	2,000,000	96,000	2,096,000	0	78,150	78,150	2,017,850
6	70/65	2,000,000	104,000	2,104,000	0	78,150	78,150	2,025,850
7	71/66	2,000,000	104,000	2,104,000	0	78,150	78,150	2,025,850
8	72/67	2,000,000	112,000	2,112,000	0	78,150	78,150	2,033,850
9	73/68	2,000,000	112,000	2,112,000	0	78,150	78,150	2,033,850
10	74/69	2,000,000	120,000	2,120,000	0	78,150	78,150	2,041,850
11	75/70	2,000,000	120,000	2,120,000	0	78,150	78,150	2,041,850
12	76/71	2,000,000	120,000	2,120,000	0	78,150	78,150	2,041,850
13	77/72	2,000,000	128,000	2,128,000	0	78,150	78,150	2,049,850
14	78/73	2,000,000	128,000	2,128,000	0	78,150	78,150	2,049,850
15	79/74	2,000,000	136,000	2,136,000	0	78,150	78,150	2,057,850
16	80/75	2,000,000	136,000	2,136,000	0	78,150	78,150	2,057,850
17	81/76	2,000,000	144,000	2,144,000	0	78,150	78,150	2,065,850
20	84/79	2,000,000	160,000	2,160,000	0	78,150	78,150	2,081,850
25	89/84	2,000,000	184,000	2,184,000	0	78,150	78,150	2,105,850
30	94/89	2,000,000	216,000	2,216,000	0	78,150	78,150	2,137,850
			4,264,000		0	2,188,200	2,188,200	

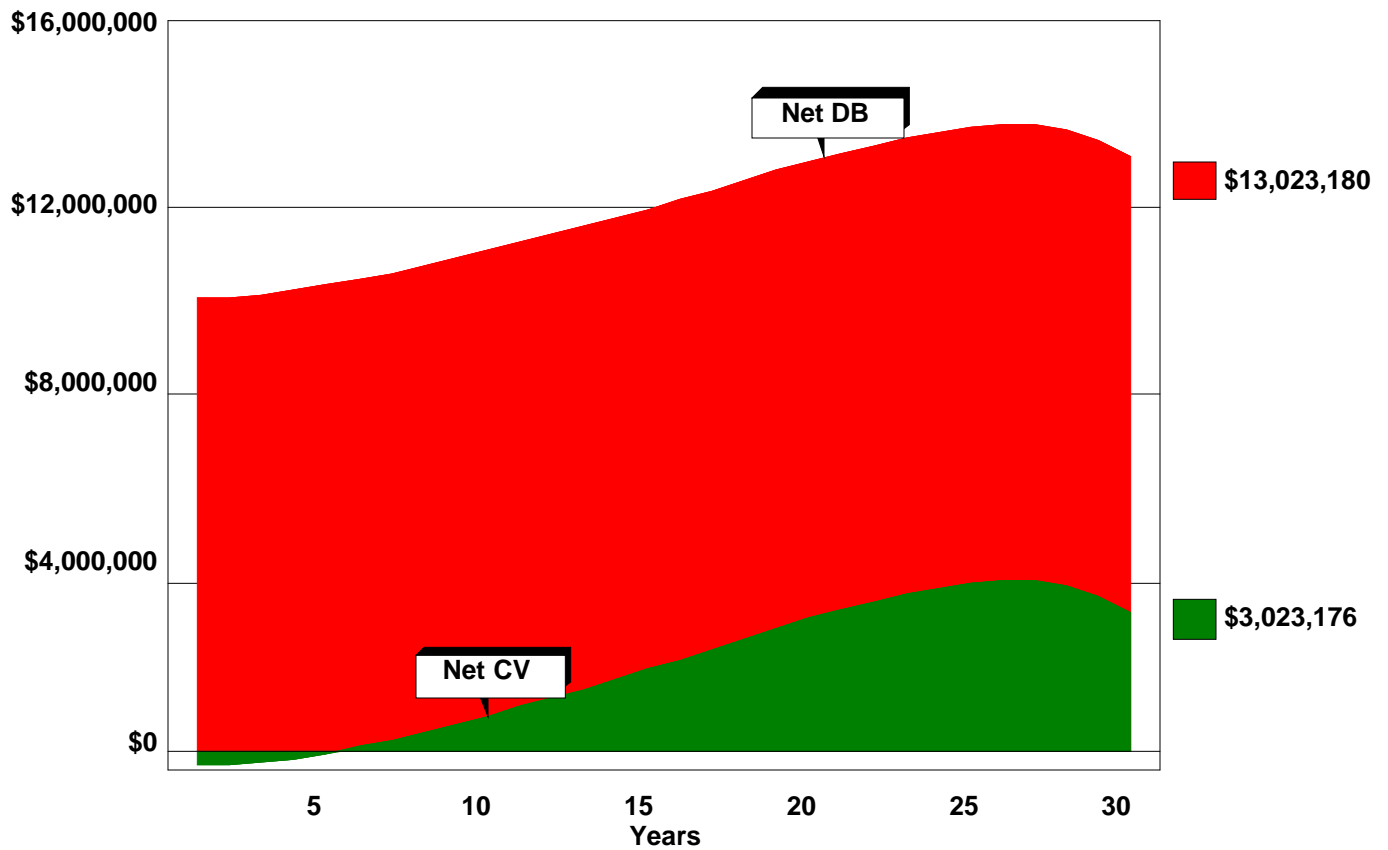
Values in Column (3) are based on client input assumptions.

Loan-Based Private Split Dollar Funded With Variable Survivor Life (VSL)

Presented By: [Licensed User's Name Appears Here]
Date: 08/17/2004

Lender and Trust Grantor: Jerry Grant
Borrower and Policy Owner: Grant Family Trust
Insureds Jerry Grant/Janet Grant

Trust's 30 Year Graphic Analysis



- Net CV - Trust's Cash Value Less Cum. Loan Due Lender
- Net DB - Trust's Estate Tax Free Death Benefit Less Cum. Loan Due Lender