

# EXIT STRATEGIES:

WITH THE LEVERAGED PLANNING® SOLUTIONS



# EXIT STRATEGIES FOR LEVERAGED PLANNING® SOLUTIONS

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## EXITING THE LEVERAGED PLANNING PREMIUM FINANCE AGREEMENT

**There are many different exit strategies for a premium financing arrangement. Each offers its own benefits and has the potential to help fulfill a client's personal or business planning needs.**

### 1 EXITING WITH THE DEATH BENEFIT

Traditionally, the interest on a program loan can be paid throughout the borrower's lifetime. When the borrower passes away and the death benefit is distributed, proceeds of the policy are used to pay back the loan principal. The remainder of the funds can be used by the beneficiaries to fund various needs such as estate taxes, burial and funeral expenses, business buyout and replacement of income.

### 2 EXITING WITH THE CASH VALUES

One of the goals of a Leveraged Planning solution may be to use a permanent life insurance policy to build up cash values from which borrowers may be able to take tax-free loans. By building these cash values, the borrower is also creating a fund from which loan principal along with interest and fees may be paid.

Should a borrower's cash values reach sufficient levels to consider tapping into them as an exit strategy, policy withdrawals are considered a loan and, therefore, must be paid back to the insurance policy, generally with death proceeds. If it isn't, the transaction could be taxable and may reduce their death benefit.

Additionally, once the premium financing arrangement is terminated, continued payments will likely need to be made on the policy in order to keep it in-force. The insured may be permitted to use cash values to fund these payments or may be able to pay the cost of insurance only (such as in a universal life policy). Either option could negatively impact anticipated cash value growth, which could impact the plans they ultimately had for the policy. However the insured chooses to handle the premiums, they will need to make appropriate arrangements after the loan is paid off.

### 3 EXITING BY ADDITIONAL FUNDING

Premium-financed life insurance policies are generally owned by an irrevocable life insurance trust (ILIT). In the "additional funding" strategy, supplementary funds are gifted annually to the ILIT. These gifts should follow the annual gift tax exclusion limits each year to avoid tax consequences. In the event that the borrower receives a windfall of some kind, they can use the lifetime gift tax exclusion and make the supplemental gift only once.

The trustee of the ILIT may use these additional funds to pay interest and principal on the loan but may also take any overfunded gifts and invest them so that they can grow. If the grantor pays taxes on this growth outside the ILIT, the gains can be compounded and, when the additional funding has sufficiently accumulated, the premium-financing loan can be prepaid.

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## 4 EXITING USING A GRANTOR RETAINED ANNUITY TRUST (GRAT)

Borrowers can create a grantor retained annuity trust (GRAT) in order to exit the arrangement.

As with an ILIT, the grantor of a GRAT gifts assets into the trust. Unlike with the premium-financing ILIT, however, the grantor is guaranteed an annuity payout from the GRAT for a specific number of years (or for life). When this period ends, any remaining funds are gifted to the ILIT holding the premium-financed policy and used to prepay the loan.

The value of the future transfer gift to the ILIT is determined on the date the GRAT is funded. To calculate this amount, the retained interest promised to the grantor is subtracted from the total gift. Next, future interest earnings on the balance are estimated by using anticipated interest rates spelled out in IRS Section 7520.

Any growth that exceeds Section 7520 rates is considered to be an additional asset that can then be moved to the ILIT and will not be included in totals evaluated for gifting limits. Once transferred, the assets can be used to pay interest or principal in the loan.

## 5 EXITING USING A CHARITABLE LEAD TRUST (CLT)

A charitable lead trust (CLT) allows the grantor to provide a current stream of income from the CLT to the charity of his or her choice while enjoying a tax deduction on that income as long as a qualified charitable organization is receiving it. This deduction can offset the interest earned on the assets gifted to the trust.

Once the CLT term ends, any remaining assets are transferred over to the ILIT holding the financed life insurance policy. With proper planning, the transfer may occur without triggering gift taxes, even when the assets exceed limits. These assets can then be used to pay off the principal or interest of the loan.

## EXIT STRATEGIES NOTES

This is not meant to be a comprehensive guide on selecting and implementing an exit strategy. Instead, it is the starting point from which borrowers can gather ideas and a basic understanding of the potential for planning opportunities within Leveraged Planning solutions. When reviewing these strategies, please remember that:

- » The ILIT holding the premium-financed policy must be named the beneficiary of the secondary trust should a borrower select either the GRAT or CLT strategy.
- » Heirs or the estate executor should be made aware of the strategy in the event that death occurs prior to the end of the GRAT or CLT term.
- » Borrowers should have all trust documents designed by an experienced estate and succession planning attorney.
- » Borrowers should involve a CPA who can speak to any tax consequences or benefits of the various strategies and to determine how their implementation may impact the taxable estate.
- » The borrower should understand the nature of assets and transfers to and within an irrevocable trust before adopting any of these strategies.

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## SELECTING THE MOST APPROPRIATE EXIT STRATEGY

In order to determine which exit strategy is best suited for a borrower, one must review several aspects of the individual planning situation, including:

- » What is the borrower's life expectancy? Will they have enough time to accrue sufficient cash values within the financed policy, or would an alternative strategy be a better fit?
- » How big a concern are gift taxes? Is the borrower gifting to other accounts or individuals, or can they maximize their gifting for the sake of the exit strategy?
- » Is it realistic to assume the assets gifted to the secondary trust or used to overfund the ILIT will be substantial enough to accumulate a sufficient return? How will taxes affect that?
- » Does the borrower have an interest in generating a personal or business income through a trust? What about generating an income stream for a charity?

## FINAL THOUGHTS

The GFD family of Leveraged Planning solutions works within the confines of each borrower's unique situation and needs, offering practical, simple solutions to business succession and estate planning concerns.

**Call us today at 800-515-2599 for more information about implementing a Leveraged Planning solution for your clients.**