



GRAT As a Split Dollar Rollout Strategy

Business clients whose current wealth transfer plans include a split dollar agreement with a survivorship policy owned by their irrevocable life insurance trust (ILIT) may face one or more of the following problems:

- ◆ The increased economic benefit cost of the coverage at older ages
- ◆ The substantial increase in the economic benefit cost at the death of the first insured
- ◆ Determining how the ILIT will repay the business at the rollout of the split dollar plan

If your clients are concerned about any of these problems, the following split dollar rollout idea may be worth considering.

Facts: Clients with significant wealth have established an ILIT that owns a survivorship life insurance policy in order to provide the needed liquidity for their heirs upon their deaths and to ensure the retention of the family business.

A non-equity collateral assignment split dollar insurance agreement has been established between the trust and their business to minimize the transfer tax costs of the premium gifted to the trust.

However, they are concerned that the economic benefit costs of the insurance will increase over the years and will escalate further at the death of the first spouse. But, if the decision is made to terminate the split dollar agreement to avoid these costs, how will the trust repay the business without access to the policy cash values?

A grantor retained annuity trust (GRAT) is a tax-efficient way to fund the payback of the premiums advanced to the business and end the split dollar agreement before costs escalate.

Solution: A GRAT can be established for a term of years timed to end the year the split dollar agreement will be terminated and the business's interest in the policy is paid back. A GRAT is an irrevocable trust in which the grantor retains a qualified annuity interest for a term of years. Any

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property remaining in the GRAT at the end of this term is distributed to the beneficiaries named in the GRAT. In this situation, the survivorship ILIT is then designated as the remainder beneficiary of the GRAT.

The grantor transfers appreciating assets to the GRAT. The transfer of the assets will be subject to gift taxation. However, the value of the gift will be reduced by the value of the income stream retained by the grantor.

During the term of the GRAT, the grantor will receive a specified dollar amount of income each year. Note that all GRAT trust income will be reported on the grantor's personal income tax return. If the grantor should die during the term of the GRAT, the GRAT will be included in the grantor's estate. If the grantor survives the term of the GRAT, the remaining assets and all appreciation will be transferred to the ILIT, providing funds outside of the life insurance policy to fund the split dollar rollout.

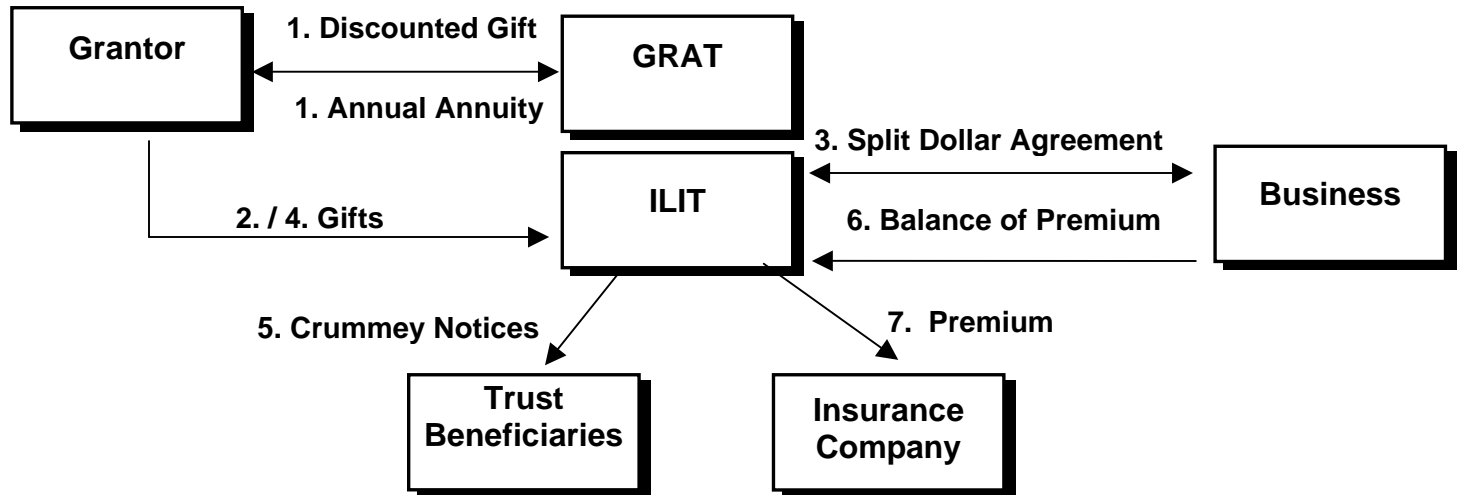
Product Choice: With PruLife® SUL Protector, clients can secure a lifetime death benefit guarantee¹ while limiting the number of payments. Scenarios where this may benefit your clients include:

- ◆ Clients who desire the security of a lifetime guarantee¹ against lapse and want to fully fund the policy prior to retirement;
- ◆ Clients who want to use the policy as part of a gifting strategy, as above, which is part of their overall estate plan; or,
- ◆ Clients who simply want to reduce the number of payments to simplify their lives.

CHARTS ARE ATTACHED



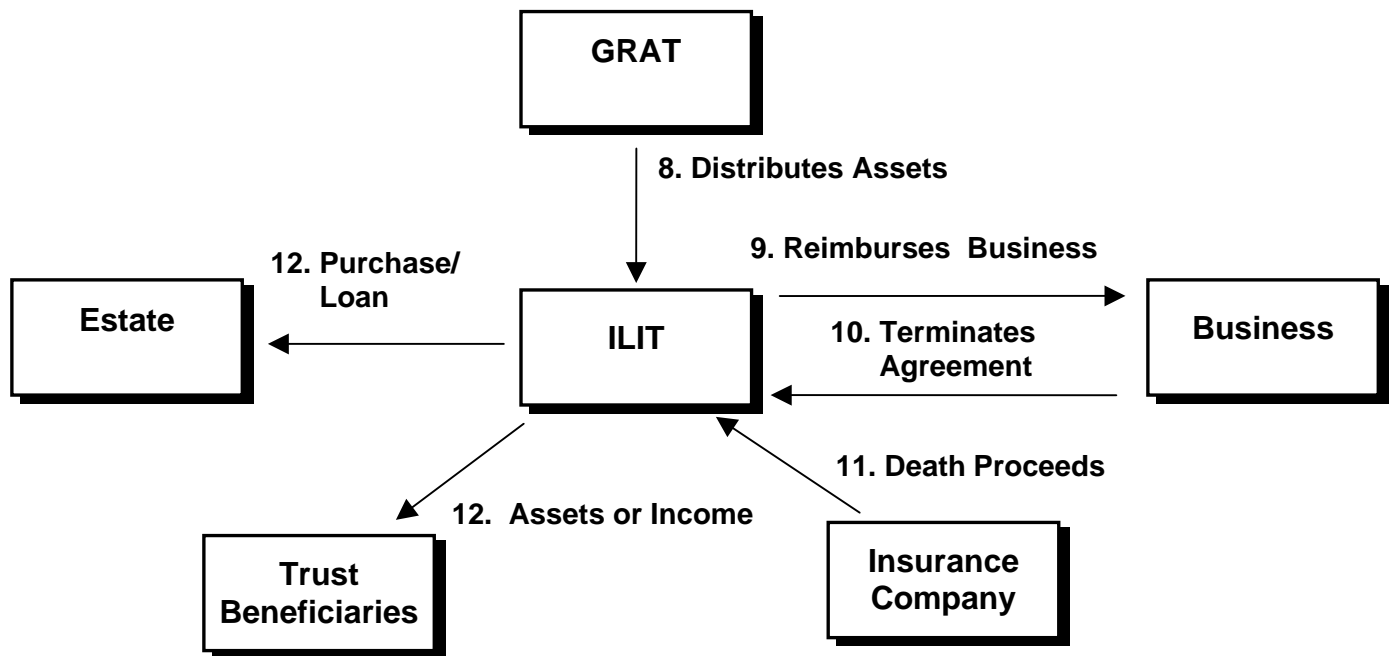
The Structure of GRAT Split Dollar Rollout During the Term of the GRAT



1. The grantor/insured (“grantor”) establishes a GRAT for a term of years equal to the time the split dollar agreement will be kept in force. The grantor transfers appreciating assets to the GRAT. The transfer is subject to gift tax. However, since the grantor retains a “qualified annuity interest” in the assets, the value of the gift is reduced for gift tax purposes.
2. The grantor establishes an irrevocable life insurance trust (ILIT) and designates the ILIT as the remainder beneficiary of the GRAT.
3. The ILIT enters into (or already has established) a split dollar agreement with the business.
4. The grantor makes annual gifts to the ILIT in an amount at least equal to either the economic benefit or the loan interest depending on the structure of the split dollar arrangement.²
5. 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.
6. The business advances the balance of the premium amount needed to the trust.
7. If the ILIT beneficiaries fail to exercise their withdrawal rights, the trustee pays the premiums for the life insurance policy to the insurer.

² The economic benefit is calculated using either Table 2001, as provided in Notice 2002-8 (2002-1 CB 398) or the rules in other IRS guidance, as applicable.

The Structure of GRAT Split Dollar Rollout At Termination of the GRAT



8. The property remaining in the GRAT at the end of its term is distributed to the ILIT as beneficiary.

9. The trustee can use either the assets, or the income from the assets to reimburse the business for the amount advanced according to the terms of the split dollar agreement. The trustee may also be able to use the cash value from the policy by taking a loan or withdrawal.³ However, a distribution of the cash value may result in income taxation, depending on the structure of the split dollar agreement.

10. Once the business is reimbursed, the split dollar agreement is terminated.

11. At death of the grantor/insured, the life insurance company pays the life insurance death proceeds to the ILIT.

12. The trustee may loan the money to the estate or purchase assets from the estate to help pay estate taxes. Assets in the ILIT are managed or distributed as directed by the terms of the trust document.

³ Based on sufficient death benefit and/or cash value availability. Loans and withdrawals may cause a permanent reduction in policy cash values and death benefits, may affect any guarantee against lapse and may have tax consequences.