

LEADING BY EXAMPLE: BEST PRACTICES IN CHARITABLE GIVING

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LEADING BY EXAMPLE:
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Why
Private Placement Life Insurance (PPLI)
and
Private Placement Variable Annuity (PPVA)

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I. Background

Income Tax Increases in 2013

	2013	2012	<u>Increase</u>
Top ordinary income tax rate -----	39.6%	35.0%	+13.0%
Top LTCG / dividend tax rate -----	20.0%	15.0%	+33.0%
Medicare Surtax -----	3.8%	0%	
Top federal rate earned income / STGC -----	43.4%	35.0%	+24.0%
Top federal rate LTCG -----	23.8%	15.0%	+59.0%

And if you live in a high tax state:

	California	New York City	Massachusetts
Top federal / state tax rate earned income -----	52.0%	53.0%	47.0%
Top federal / state tax rate LTCG -----	33.0%	33.0%	28.0%
Top federal / state tax rate on investment income (70% STCG/ 30% LTCG) -----	46.7%	46.4%	41.9%



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II. Why is PPLI / PPVA better than a Roth IRA... for HNW Clients

	Roth	PPLI / PPVA
Annual contribution limit	Yes (\$5,000)	No
AGI limit	Yes (\$188,000)	No
Investment restrictions	Yes	No
Retail or institutional pricing	Retail	Institutional
Available to all investors	Yes	No
Customized investments (hedge funds)	No	Yes



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III. Why PPLI / PPVA over Traditional Products

PPVA

- No upfront charges on premium investments
- No surrender charges

} Retail annuity has these

-
- No K-1

PPLI

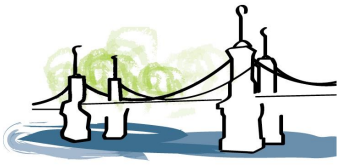
- Lower fees
- Access to broader investment range
- Death benefit minimized / reduces mortality costs
- Minimize state premium tax
- No surrender charges

} Retail life insurance has these

-
- No K-1

PPVA / PPLI

- Accredited investor / qualified purchaser required
- Access money managers / hedge funds not available in traditional retail annuity / life insurance products
- High minimum investments (\$1M for PPVA, \$2M-5M for PPLI, PPLI funded over 4 years)
- Policy assets held in segregated account by carrier (not available to carrier's creditors)
- Lower costs, lower commissions (agent, carrier fees measured in bps) than most retail products



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IV. PPLI vs. PPVA: Taxes

> Both provide tax deferred growth (but PPLI may eliminate tax on growth if held til death)

> **Access to policy growth during life:**

PPVA

- Taxable (LIFO, all ordinary income first, 10% penalty on distributions before 59 1/2)
- Can annuitize over life expectancy, part return of basis, part gain on each payment

PPLI

- If premium paid in over at least 4 years, policy not a MEC
- If not a MEC, owner can borrow tax-free up to cash value or take withdrawals up to basis tax-free

> **At Death:**

PPVA

- Subject to income tax unless surviving spouse continues deferral (i.e. better to leave to charity than child)

PPLI

- No Income tax on death benefit

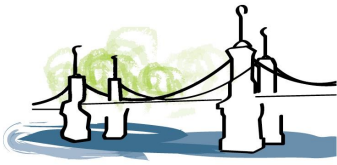
> **Estate Tax:**

PPVA

- Yes, unless spouse is beneficiary (marital deduction)

PPLI

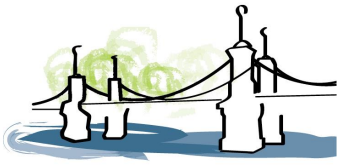
- Yes, unless spouse is beneficiary (marital deduction) or ILIT owns policy / split dollar funding



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V. Potential Benefit of PPLI

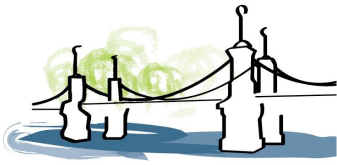
- Can allocate among different investment portfolios offered by carrier
- Existing policy can be exchanged for new policy free of income tax
- Earnings accumulate tax deferred until distributed
- If policy structured as non-MEC, policyholder can withdraw premiums paid and borrow against earnings at low effective interest rate, both free of income tax
- Entire death benefit generally free of income tax
- If funding structured as AFR loan (split dollar) to ILIT, no estate tax due on net death benefit (in excess of loan repayment at death)
- May block U.S. tax consequences of effectively connected income (ECI) for foreign investors
- Can reduce state premium tax (normally 2.0%) down to 0.08% if policyholder is trust / LLC in SD or DE



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VI. Factors to consider in PPLI strategy

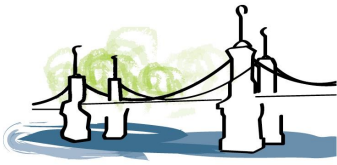
- Tax impact - does investment choice generate enough taxable income to justify 100bps (1%) annual fee on assets?
 - If \$10M to invest, will taxes exceed \$100,000 in fees (1%)?
 - If investments generate more than \$230,000 ordinary income (hedge funds, high turnover, interest) tax is more than \$100,000 and PPLI is better after-tax return
 - If investments generate more than \$420,000 of LTCG, (long investments, private equity), tax is more than \$100,000 and PPLI is better after-tax return
 - If client resides in high tax state (CA, NY), lowers threshold for PPLI to be better after-tax return
- Client insurable? Or another family member
- Investment choices:
 - Large number of investment houses already have IDFs (insurance dedicated funds)
 - Or does client want a tailored fund? If so, investment manager must create IDF (investor can't control / select underlying investments)
- Willing money manager:
 - Will favorite money manager set up an IDF or SMA (separately managed account); size of investment matters?



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VII. Charitable use of PPVA

- Lower costs (no mortality) than PPLI
- Defers income
- Disadvantageous tax rules on lifetime distributions
- Better strategy is to accumulate investment income as rainy day / charitable vehicle
- No income guarantees / protection as with retail annuities
- No forced distributions (until age 95/100, but can withdraw over 30 years)
- PPVAs are sanctioned by tax code
- Client can make single / multiple deposits
- Not dependent on investor's health



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VIII. Charitable use of PPVA (continued)

- Charitable legacy at death:
 - Investor retains complete control over PPVA during life and selects investment options
 - Income taxes deferred on accumulated gain, investor can add deposits or take withdrawals (subject to tax on gain)
 - At death PPVA account balance passes to foundation / charity free of income tax (no income tax on earnings) and estate tax
 - Use of PPVA for charity increases size of family's legacy
 - Public charity recognition for PPVA, even if primary beneficiary designation is revocable
 - Can name surviving spouse as primary beneficiary, charity as contingent beneficiary of PPVA account (cascading beneficiary designations)

- Private foundation wants to allocate to investment assets with active business interests:
 - Certain assets (timber, energy, transportation, MLPs) can create current tax (UBTI) and endanger tax-exempt status
 - Use of PPVA as inexpensive blocker of UBTI
 - PPVA eliminates UBTI, changes character of IDF investment from UBTI to passive income
 - IRS has issued favorable rulings to tax-exempt organizations (endowments / foundations) allowing PPVA investment to block UBTI