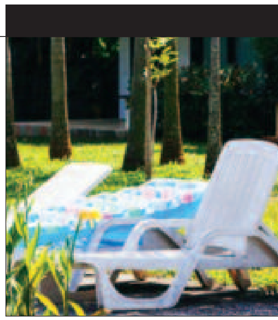


Why Billionaires Acquire Life Insurance

Reviewing the benefits of planned liquidity in high net worth estate planning.

RICHARD L. HARTMANN, JD, CLU, CHFC, TEP

The answer quite simply is because they are financially astute. They see life insurance for what it is, the only financial instrument in the world that delivers a stated amount of money at an unknown time in the future, regardless of uncertain financial conditions.

While the above statement is absolutely true, billionaires are like eagles – they soar individually, they do not flock - so general statements are not inclusive answers. There are new billionaires and multi-generational billionaires, young and old, active business owners and full-time investors, each making their own path. While many ultra-affluent families utilize life insurance in wealth succession planning to pay or assist in paying the 40% estate tax, there are numerous reasons life insurance is implemented as a planning strategy. It has been used by this savvy sector because of its simplicity, its statutory income tax free characteristics, its controlled "protection" feature, its certain liquidity at unknown future economic times, and because it is a non-correlated asset that may fill a bucket in the family's total portfolio. There is one thing that seems to be unique to the ultra-affluent decision process, however, they acquire life insurance because they use it as both an OFFENSIVE and a DEFENSIVE strategy. Offensively it preserves their wealth multi-generationally, and defensively it protects, in bad economic times, the assets they want to preserve long term. The purpose of this article is to explore some of these concepts in detail.

After law school, RICHARD L. HARTMANN began his career in the Advanced Tax Planning Division of a major, highly rated life insurance company. He experienced the role of a Company officer before leaving to co-found AUCTORIS, a national and now international personal wealth and business succession planning firm, near Denver, Colorado. With counsel he has provided to his clients and their advisors, integrating insurance strategies into their often complex inter-generational estate and wealth plans, over $4 billion in wealth shrinkage due to estate tax has been avoided, and over $2 billion in wealth has/is going to charity. Today, he continues values based planning with ultra-affluent U.S. and international families and their trusted advisors to refine efficient strategies using exclusive life insurance products for the preservation and protection of their wealth.

Taxation and Life Insurance

The principles below are important to understand:

- Life Insurance proceeds are received income tax-free;
- Proceeds can also be free of the gift and estate tax and the generation skipping tax for multiple generations if the policy is not owned by the insured;
- Premiums are generally paid with after income tax dollars, although there are planning strategies that allow premium payments with income tax-free dollars;
- Cash value inside of a life insurance policy grows free of income tax;
- Withdrawals from the cash value (or surrender of additions from whole life) are income-tax free up to the total premiums paid

into the policy from any and all sources;

- After withdrawals, additional cash can be accessed from the policy income tax free via policy "loans." The "loans" do not have to be repaid according to any schedule and ultimately reduce the gross death benefit. Generally accepted accounting principles state that loans from policies are not to be characterized as loans on a financial statement. Rather the "net cash value" (gross cash value less the loans) is stated as an asset; and
- If a policy is surrendered or lapses during the insured's lifetime, the excess of the policy gross cash value (assuming no loans) less the cumulative premiums paid from any and all sources, is taxed as ordinary income to the owner.

Premium Sources

Assume insurance is owned in a trust for estate tax benefits. Premiums can be paid from many sources, and generally, the more planning a family has done the more sources there are available. Regardless, the premium source and the insurance must be integrated into the balance of the planning. Some alternative premium sources used in planning from simple to more complex are:

- Annual tax-free gifts from husband and wife of Generation 1. It results in $30,000 multiplied by the number of beneficiaries that meet the definition. It could be the number of children in G2 plus their spouses, plus the number of people in G3 and their spouses. With three married children and each couple having two children, the annual gift tax-free amount that could be gifted to the trust for premiums is $30K x 12 or $360,000.
- Use of Lifetime Credits. While there are generally more leveraged ways to use some, most, or all of the lifetime credit, it can be used to gift premiums. Today, the credit equivalent amount is $11.58 million per person total for lifetime ($23.16 million per couple). If it is not used prior to 2026, the amount is scheduled to decreased to $5 million per person or $10 million per couple (adjusted for inflation since 2017).
- Income or principal of assets in a trust.
- Tax-free income to a special trust where the one who established the trust (Grantor) pays all income tax on the trust income. Grantors use this strategy as a way to decrease their growing estate without the payment of the income tax for the trust being considered a gift to the trust or the beneficiaries.
- Low interest loans from a family member, a family entity, a family business, or another trust with good cash flow or one with liquid assets. At this time, intra-family loans can be made at 0.58-1.15% interest. This is an ideally suited strategy where the premium is sizeable and its payment by the insured or trust grantor would result in taxable gifts or using part of the gift tax credit. It can also be a solution to the situation where there is an unfunded trust to own life insurance and there is another family trust or family business with good cash flow or liquidity that could make annual loans to the unfunded trust without gift tax consequences.
- Tax-free institutional loan. In situations where (i) the premium is sizable and would force taxable gifts; (ii) the family wealth is highly illiquid; (iii) the family is getting a great return on their reinvested cash, borrowing premiums, income tax-free, from a financial institution and collateralizing the debt with the policy cash value is a possible solution. Properly designed, the loan can be repaid with income tax free dollars from the insurance policy cash values. The "cost" of the insurance is no longer the premiums advanced, but only the cumulative interest on the premiums borrowed. Interest is generally 30-day LIBOR plus 0.65-3.0% depending on the banking relationship, size of the transaction, etc.; or (iv) for the very sophisticated and those with greater risk tolerance, there is currency straddle premium finance through Swiss banks at lower interest rates.

Non-Tax Rationale

- One premier insurance carrier in this ultra-affluent market is not requiring insurance physicals of insureds (unless there are no medical records available) making the process less burdensome and less invasive.
- Cash values can be free from creditors.
- Proceeds are not subject to probate because the policy is generally not personally owned, and the proceeds pass by contract to the named beneficiaries.
- The cash value may not be subject to insurance company creditors (Variable Life and Private Placement Variable Life).
- Significant amounts of insurance on one family are generally diversified with 3-9 insurance companies.
- Internal Rates of Return (IRR) at life expectancy of 7-11% pre-tax are not unrealistic.

Types of Products

The type of product chosen for a wealth plan is totally dependent upon the purpose of the insurance and a plan may include more than one type of insurance product to meet immediate and long-term needs or goals. This is a sizeable topic unto itself and therefore will not be covered in detail in this article. In brief, products considered for hecto-millionaires and billionaires must include Term, Universal Life, Whole Life, Variable Life, Indexed Universal Life, and Private Placement Variable Universal Life (particularly for sheltering, alternative investment income from current annual income taxes).

The Double Duty Asset – An Offensive And Defensive Strategy

While the most obvious reasons for acquiring significant amounts of life insurance are part of an "offensive" plan of wealth succession – gifting, passing on a family business, paying estate taxes on what remains in the estate after proactive strategies have been implemented, etc. – the ultra-affluent have taught observant planners that they must balance offensive planning with a good defensive plan. Tremendous energy and creative professional time is spent on developing plans to transfer existing and growing wealth, tax favored, to future generations. In fact, that has been the primary motivator for planning for at least the last two decades. Only "seasoned" planners know through experience that it is equally important to protect the wealth that is the subject of the planning, because not all times are good economic times. Life insurance is the only financial tool that shores up an offensive plan in times of great distress. It can protect an estate from:

- Adverse financial consequences resulting from a sudden drop in the economy for any reason, like the COVID-19 pandemic, and
- Death of an estate owner when the real estate or financial markets are depressed, making liquidity very expensive or impossible to access.

There is one thing that seems to be unique to the ultra-affluent decision process, however; acquiring life insurance becomes both an offensive and a defensive strategy

A couple of examples will illustrate the concept with greater clarity:

- CLIENTS A acquired over $120 million of insurance as part of their offensive wealth succession and preservation plan to pay estate taxes. Husband died a number of years ago and there have been no premiums due on their survivorship policies since then. After husband died, an investment series in which they had a significant position deteriorated and potentially jeopardized the surviving spouse's lifestyle short term. If not immediately addressed it could have mandated undesirable changes for her late in life after a long life of affluent living. $40 million of cash value on their $120 million of insurance was available to the family without adversely affecting the death benefit long term. It shored up the surviving spouse's assets while the investment issue was settled, and her lifestyle went back to normal.

  There is a saying that "the value of a dollar is its availability." That certainly proved true in this situation.
- CLIENTS B have over $200 million of death benefit acquired to pay estate taxes on their business in the event they died while it was growing. When the business sold for over $1 billion and the owners were totally liquid, the question was raised, "why keep the insurance?" With no further premiums due, it was kept in the trusts for two reasons; (i) it was an alternative non-correlated investment with an excellent projected rate of return outside of the taxable estate of the insureds (it consisted of index universal life policies, so it participates in market upsides while the values are protected with a floor of 0% from market declines during "adjustments"), and (ii) it will be used to partially replace the capital that will be lost to estate taxes on the now liquid estate. Then came the COVID-19 pandemic and cash *demands* on CLIENT B's hotel and resort investments and a bank debt over $40 million. The defensive element of life insurance proved adequate to calm the water. Over $55 million of cash value not subject to any reduction because of a volatile market appeased the bankers to ride out the storm. This defensive characteristic of tax-free cash, not capable of being impacted by market volatility, inside a life insurance portfolio acquired for offensive planning was the defensive tool that *protected* the wealth during an unprecedented time.

The second way a quality life insurance portfolio acts defensively is by providing a tax-free death benefit also unaffected by financial or real estate recessions. If the 40% estate

tax is devastating to family wealth when the estate owner dies in good economic times, what are the consequences of dying at the brink of or during a huge and potentially prolonged economic downturn? For example, if an estate owner is worth $200 million, half in real estate and half in securities, what are the consequences of death when the market is down 30% and there is little activity in real estate…except from bottom feeders?

- Estate value is down to $140 million.
- Estate taxes would be $56 million.
- Liquid securities have decreased to $70 million and now $56 will be sold for estate taxes leaving only $14 million net liquid.

When the market recovers totally (43% increase to get back to normal over some time) the securities portion of the estate will be *only* $21.4 million, a net loss of $79.6 million to the heirs. The curse of dying at the wrong time! It is unlikely the family will ever fully recover as the estate will be divided among siblings and more demands will be made on less wealth.

A "defensive plan" *protecting* the family's wealth would have had some of the $100 million securities reallocated to an estate tax life insurance portfolio impervious to market fluctuations short or long in duration. The cash values would be readily available anytime but more importantly, the $56-80 million insurance would reimburse the family resulting in no net loss to the family wealth or lifestyle. And when the market recovers that 43%, the family would have $100 million in securities versus $21 million without the "defensive plan," protecting the family wealth in poor economic times.

Ultra-Affluent Uses Of Life Insurance

Experience among insurance professionals suggests that ultra-affluent families acquire life insurance when what is proposed and how it is to be paid is fully integrated into the family's plan of business and/or wealth succession. Primarily though, the proposed insurance plan must address a problem or take advantage of an opportunity more efficiently than any other financial instrument. The insurance professional must understand the complex tax and financial structures and appreciate that insurance is part of an integrated planning process and should be modeled that way. Its placement is not merely a transaction.

Existing insurance portfolios and the payment arrangements should be reviewed and financially modeled to and beyond life expectancy, even if the policies are with quality carriers.

Following are several case examples of ultra-affluent individuals using life insurance. The purpose of the examples here is to understand *why* each utilized the strategy of life insurance. It is not to cover in detail the ownership and tax benefit of the structures used. The structuring of ownership and the rationale for it in these complex families, like a discussion of all product types, requires an article unto itself. That is beyond the scope of this article.

Family with considerable alternative investment income and GST tax issues.

A portion of the family's billion dollar plus wealth was invested in hedge funds and other alternative investments by excellent advisors. Results were impressive, but so were the 40%+ income taxes that resulted each year. $300 million of assets were in a single generation trust directing that only 4% be distributed to G2 each year and the balance be retained in trust until it passes to G3 at G2's death. Legal counsel asked if something could be designed to:

1. Shelter the income accumulation above 4% from income tax;
2. Transfer the growth to a new trust that would be free of Generation Skipping Tax (GST) at G2's death; and
3. Realize market growth on the $300 million.

The desired result called for both an income tax strategy and a generation skipping tax strategy in addition to the financial strategy to keep assets "in the market." The following was proposed as the design:

- Create a New Trust for G3 and future generations;
- Loan assets (private premium finance) from the existing trust to New Trust;
- G2 (son) will continue to receive 4% income from existing trust;
- New Trust to acquire private placement life insurance on G2 (son); and
- Existing trust to use annual interest payments from loan to New Trust to acquire additional private placement life insurance on G2 (son).

This resulted in the following, as illustrated in Exhibit 1:

- Most income in excess of 4% is sheltered from income tax forever;
- The assets are invested in "the market" (trustee's direction) via private placement life insurance; and

- $300 million trust principal is effectively transferred to a multi-generation GST tax free trust.

These changes allow wealth to be transferred to/for future generations on a gift/estate/GST tax leveraged basis (see Exhibit 2). The pearl of wisdom from this case study is that creativity and communication among quality advisors can generate unique opportunities to minimize taxes.

Significant family held business

> To build wealth you follow one path with absolute conviction, you 'go for it.' To retain wealth, you examine ALL alternatives and PLAN - Client

The family owned a rapidly growing business. Mother and Father formed this business just ahead of the trend, so they rode a wave of growth nationally. Father was also astute in that he knew the impact of a 40% estate tax if they died during the business growth phase. So, he elected to protect the family business (90% of the family wealth) at the same time as he was growing it.

With little excess cash flow, the insurance transaction "advice" he received was to borrow the premiums

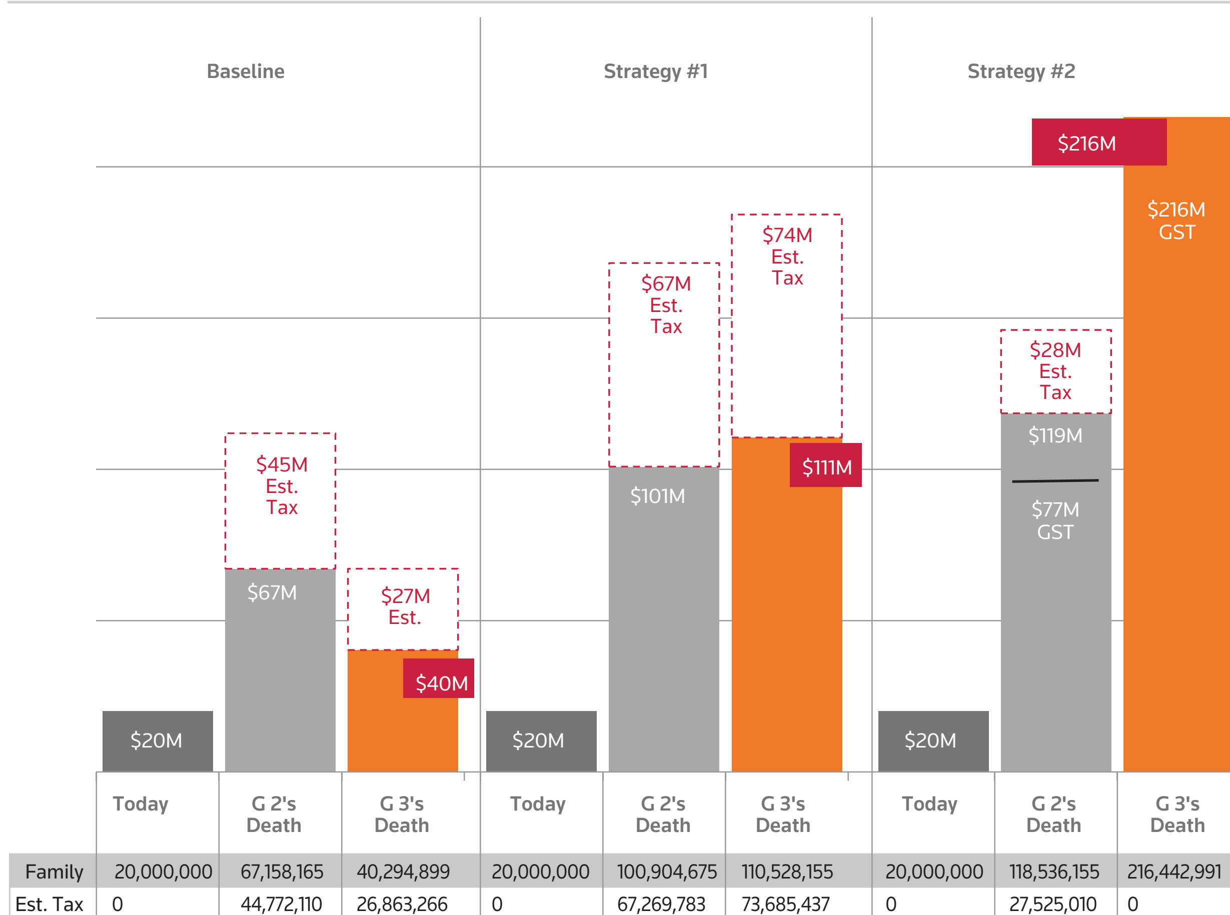
EXHIBIT 1
Existing Planning Compared to Proposed Design

Without Additional Planning		With Private Finance Private Placement & New Trust
$300M	TODAY	*$300M*
$355M	At G2s Life Expectancy	*$503M**
$213M	At G3s Life Expectancy	*$715M***

**$232M of the $503M is in the New Multi-Generation Trust*

***All $715M is in the New Multi-Generation Trust and could be enhanced if G3 also utilizes life insurance in inside the new GST*

EXHIBIT 2
Total Assets Available at G3's Death Assuming 3 Units ($60 million) of PPVUL from $300 million Trust)



	Today	G 2's Death	G 3's Death	Today	G 2's Death	G 3's Death	Today	G 2's Death	G 3's Death
Family	20,000,000	67,158,165	40,294,899	20,000,000	100,904,675	110,528,155	20,000,000	118,536,155	216,442,991
Est. Tax	0	44,772,110	26,863,266	0	67,269,783	73,685,437	0	27,525,010	0

on $170 million of insurance placed with five (5) insurers. He had a business growing to a goal of $1 billion and if he and his wife died, it was going to be protected from forced sale for estate taxes. No cash flow out of pocket or out of the business for the estate tax insurance was ideal.

Twelve years later the business was sold for over $1 billion and a multi-family office was engaged to review their planning and assist them in their life/business transition. The multi-family office sought the counsel of an insurance planning professional for a review of the insurance portfolio *and* the payment arrangement. The professional found the following:

- All excellent life insurance companies.
- No one had modeled the insurance arrangement to life expectancy, either at inception or during the succeeding twelve years of declining interest crediting rates and declining dividend scales.
- Trusts were adding interest on the cumulative premium loan to loan principal each year.
- ALL the insurance products were inappropriate for premium financing.
- Due to a long-term, low interest environment, no policy reviews or service, and no policy adjustments, the insurance was not performing as projected.
- If the client surrendered all policies immediately, they could pay off a $43.6 million loan with cash values, pay $4 million income taxes out of pocket on gains in the policies, have NO insurance going forward, but be free of any future interest on premium payments.

Modeling the plan to life expectancy illustrated a projected a debt of $185 million and total death benefit of only $170 million. That would leave the family trusts $15 million under water. If husband or wife were to live three more years, the trusts would be under water $54 million. An important reconfiguration was necessary:

Listening to client's goals and motivations, integrated with tax planning and life insurance, can generate huge positive results. A plan must be viewed in its entirety to remain objective.

- Refinanced the premium finance loan to save 110bps per year ($480,000 interest savings per year);
- Stopped all future premium payments by loan or out of pocket;
- Froze the debt and designed paying annual interest from cash flow;
- Reconfigured the life insurance using exclusive products for ultra-high net worth individuals providing full guarantees into the mid-90s and protection into their 100s;
- Tax-free exchange (Section 1035) of the financed policies resulted in more than $200 million of insurance ($157 million net of the bank loan) to the trusts if death occurred today, at life expectancy, or beyond; and
- The pre-tax IRR in their tax bracket at life expectancy is projected to be 10.9%.

The first lesson learned was that existing insurance portfolios and the payment arrangements should be reviewed and financially modeled to and beyond life expectancy, even if the policies are with quality carriers. Second, having policies from a high-quality carrier does not mean that the policies utilized are appropriate for the clients goals. Third, any policies older than three years are likely NOT performing as projected. Fourth, policies originally acquired for one reason (estate taxes) may later be kept for a different reason (alternative tax-free investment outside insured's estate).

Highly Liquid Family Wealth

> For a 'capital call' of 40% of my net worth, I would prefer to plan with the 'certainties' of today rather than have my family chance dealing with the uncertainties of tomorrow. – Client

Male client, age 79, owns a significant portion of a development company. He sold a majority of the equity to one son via a grantor trust for a note. His other son is not in the business. The family attorney, CPA, and investment team know father is quite liquid and that he guards that liquidity as his security for life. To this point in time, insurance was never considered in his plan because he thought his wealth protected him. Father was counseled by a large national bank to talk to someone about life insurance. At the first meeting he asked, "am I too old for life insurance?" and "why would I use it if I am quite liquid?"

Projected results at death under current planning

- Taxes would devour 100%+ of his liquidity;
- The note receivable from the trust for Son 1 would be stressed because a portion of it would have to be paid off to provide liquidity for father's estate tax. A portion of Father's estate may qualify for the Section 6166 14-year spread out of the tax on the portion of the business in his estate; and
- Son 2 would have no liquid assets from Father's estate and

would (through the trust) hold the note from his brother through which Son 1 bought the business.

Could a life insurance plan be designed that would not jeopardize the personal "emergency" lifestyle security liquidity, that would complement other planning, and would provide a significant savings over outright estate tax payment and/or the 14-year spread-out? Four alternatives were presented, the most efficient being a combination of life insurance under a private premium finance arrangement at rates below bank interest rates. It avoided any gift tax consequences.

- The present value cost of the plan of life insurance and premium financing to pay the estate taxes is 62% less than the next best alternative (cash), if he had cash;
- Father will loan premiums to the trust each year;
- Trust pays father interest. If father needs cash, the trust can repay part of the note or loan father what he needs; and
- Father may have an assignment on the policy to protect his liquidity.

Here also there was a pearl of wisdom. Creativity in custom designing both insurance product and the premium source is vital. The Plan of Liquidity must be uniquely integrated into the client's overall wealth succession and cash flow plan.

> Given alternatives, my clients with a significant percentage of their net worth allocated to illiquid assets would feel a greater degree of certainty, proactive control over, and efficient deployment of capital to implement their complex wealth planning by effectively "borrowing premiums" today at this continued historic low interest rate environment, so that 100% tax free insurance will be available to pay resulting estate taxes, than doing nothing today and hoping the next generation could either borrow the 40% estate taxes at their death, at interest rates that may be significantly higher. In addition, the tax-free liquidity afforded irrevocable trusts owning the Premium Financed Life Policies structured intentionally could also generate additional estate tax reduction benefits per 'Graegin Note Planning.' It is all about relative control of their wealth and the economics of the alternatives.
> - John Grzybek, President, Clarity Family Offices

Commercial real estate developer. Client is 70 years old, with an estate greater than $1 billion. Client has not planned, thinking he could not use minority discounts like his father had, because he owned 100% of the company. He had $10 million of life insurance and did not see the benefit of another $10 million. All would agree, for what would $10 million do for a more than $400 million estate tax?

This situation demanded a plan to stop the hemorrhaging before the problem could be addressed. The taxable estate had to be reduced, then "frozen" in value. After that, the estate tax liability could be quantified and potentially addressed with a plan. A three-point plan was proposed, which:

- Created minority interest in his business to reduce his estate 35-45% immediately,
- Transferred 90% of the business growth out of his estate, and
- Reduced the cost of paying his estate taxes by 84%.

In simplistic terms, all his interests in the myriad of LLC's were placed into a Master LLC with 10% voting interest and 90% non-voting interests. The non-voting interests would avail him of a 35-45% discount through other wealth succession strategies. He transferred 90% of the company to a multi-generation trust using the "sale to a defective trust" strategy. Side benefit: other investors would be protected from recognizing gain in the forced sale of properties for this person's estate taxes.

See preliminary results in Exhibit 3. Much more sophistication was

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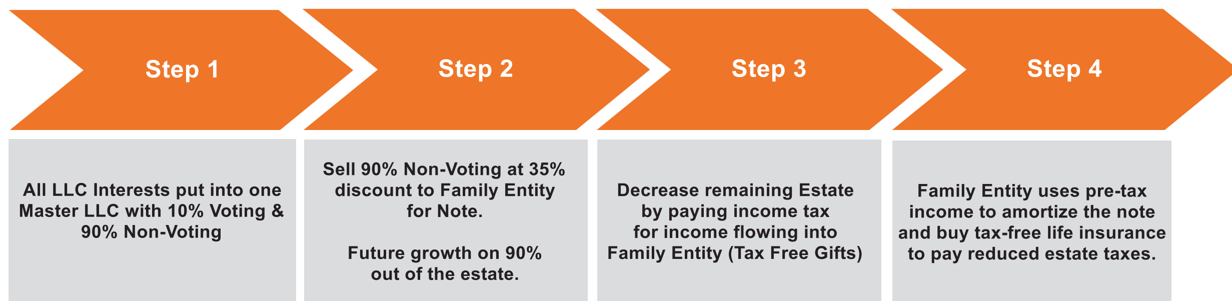
EXHIBIT 3

Four Steps to Reduce Taxable Estate

$704M Estate Tax Reduced 84%

$1.0B Estate Growing to $1.76B by Life Expectancy Becomes $710M for Estate Tax Purposes



	Taxable Estate	Taxes/Cost of Paying Estate Tax
Today	$1.0B	$400M (40%)
At Life Expectancy (LE)	$1.76B	$704M (40%)
After Steps 1 & 2	Discount <$315M>	<$126M>
	Growth <$495M>	<$198M>
After Step 3 (at LE)	"Burn Off" <$240M>	<$96M>
	$710M	$284M (40%)
After Step 4	$710M	$6.4M annual payment by trust to insure $284M tax*

**total cost at life expectancy is 6.5% of feamily wealth versus the 40% if paid estate tax in cash or by selling real estate*

Results:	***Planning*** *Decreased Taxable Estate by* ***$1.05B or 60%***	***Planning & Insurance*** *Decreased Cost of Paying Estate Tax by* ***$589M or 84%***

added to further leverage down the cost of life insurance while keeping business cash flow available for further growth and development. Through modeling, institutional premium financing was found to generate the greatest "cost" savings for the plan. In the diagram "the plan" is illustrated without premium financing so the grantor trust is paying annual premiums. The educational points from this case are several. Listening to client's goals and motivations, integrated with tax planning and life insurance, can generate huge positive results. A plan must be viewed in its entirety to remain objective. One part of the proposed plan without the other would not be sufficient to keep the real estate empire from forced sale.

Foreign national billionaires acquiring life insurance. Ultra-affluent foreign nationals acquiring U.S. life insurance as part of their sophisticated cross border planning is causing that segment of the life insurance business to be the most rapidly expanding. What is their rationale for seeking not just life insurance, but U.S. life insurance in particular?

Offensively they frequently have the same needs and desires as U.S. billionaires:

- Provide a pool of tax-free capital to pay death taxes, or reimburse the family for wealth lost in paying death taxes;
- Provide for their spouse, and culturally for children who may not be involved in the family enterprise;
- To fund business succession plans with partners;
- To have a portion of their wealth in a U.S. entity, a trust protected by stable tax laws and several hundred years of court interpretation;
- Tax benefits: tax free growth of cash values, premium payments free of gift tax, death benefits free of U.S. income and estate taxes, and potentially free of tax in their country of residency and citizenship;
- Asset diversification as life insurance is a non-correlated asset and can be free of the negative volatility of the financial markets;

- To provide for children and younger generations electing to live in the U.S.

Ultra-affluent foreign nationals may have had historical experiences in their countries that cause them to see the world differently and therefore acquire significant amounts of life insurance as part of a defensive plan as discussed in detail in this article. While those reasons are sometimes extremely personal, two are certain and have been repeatedly stated:

- To be assured their family has, and maintains into future generations, sufficient wealth to remain a respected and influential family in their region or country; and
- Most, if not all LATAM countries, have had staggering inflation and have seen their in-country life insurance face amounts become meaningless. Having U.S. dollar protection gives them currency stability, wealth protection, and diversification.

Unique Products For Ultra-Affluent Clients

Integrating life insurance ownership and its accompanying premium payments into an existing or developing multi-generational plan is vital for financial and tax efficiency. It is important to have a knowledgeable insurance professional with tax and planning experience to work with the team–one who has accessibility to products developed and priced exclusively for ultra-high net worth individuals from highest rated carriers and direct access to the world's top reinsurers. With that combination, $250-350 million or more of insurance can be compiled for a person or couple while diversifying the risk among several companies.

Several years ago, a select group of insurance professionals, through ownership of an insurance company and actuarially certified mortality, established that there should be a pricing difference (reduction) on life insurance for ultra-high net worth individuals. Today there are several major companies that offer proprietary products exclusively through M Financial Member Firms based upon the following accumulated statistics. Ultra-affluent individuals:

Ultra-affluent foreign nationals acquiring U.S. life insurance as part of their sophisticated cross border planning is causing that segment of the life insurance business to be the most rapidly expanding.

- Acquire policies 10 times industry average policy size;
- Have 14% lower mortality than the industry average; and
- Have a 10-year retention rate 177% better than the industry average

These three demonstrable advantages have created pricing efficiencies reflected in proprietary products from several of the highest rated insurance companies but not available in the open market.

Education is Vital

In the sophisticated planning world of the ultra-affluent, countless hours are committed to successfully transferring very significant amounts of wealth. All the steps are worthwhile: valuations, reorganizations, legal counseling, and document preparation, etc. to implement strategies that are generally well proven. All of that is time spent on the "Plan of Distribution," identifying who gets what and when they get it. It is this author's experience that there is not a proportionate amount of time spent by the planning team of advisors on the "Plan of Liquidity," or planning in advance for paying the estate tax when that time comes. All the advanced planning strategies serve to reduce the taxable estate but generally do not get it to zero. So, what are the alternatives available to create the liquidity to pay the estate taxes remaining after the complex estate reduction planning? There are seven ways (or a combination of seven) to provide for the payment of estate taxes. Rarely are all seven methods laid out and discussed openly by the team with the estate owner:

1. Cash;
2. Borrow from a bank;
3. Borrow from the government (Section 6166) if a significant portion of the estate value is a business;
4. Estate tax life insurance;
5. Liquidate marketable securities;
6. Sell illiquid assets (eg: real estate) at a discount; and

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EXHIBIT 4
Life Expectancy in 22 Years

Years	Cost of Paying $33.3M of the Estate's Taxes			
	Bank Loan Term 10 Loan Rate 4%	Life Insurance Private Premium Financing Opportunity Cost 2%	Liquid Assets Discount / Costs 2%	Graegin Loan Term 15 Loan Rate 8%
PV	$ 23,854,646	$ 3,838,797	$ 21,979,326	$ 18,593,221
1		20,307		
2		40,614		
3		60,921		
4		81,228		
5		101,535		
6		121,842		
7		142,149		
8		162,456		
9		182,764		
10		203,071		
11		223,378		
12		243,685		
13		263,992		
14		284,299		
15		304,606		
16		324,913		
17		345,220		
18		365,527		
19		385,834		
20		406,141		
21		426,448		
22	$ 36,878,797	$ 6,053,395	$ 33,979,592	$ 28,744,742
23	4,105,588			936,000
24	4,105,588			936,000
25	4,105,588			936,000
26	4,105,588			936,000
27	4,105,588			936,000
28	4,105,588			936,000
29	4,105,588			936,000
30	4,105,588			936,000
31	4,105,588			936,000
32	4,105,588			936,000
33	-			936,000
34	-			936,000
35	-			936,000
36	-			936,000
37	-			23,436,000
	$ 41,055,884	$ 5,137,686	$ 33,979,592	$ 36,540,000

By Using Private Premium Financing Life Insurance, the Cost of Paying the Estate's Taxes is Reduced by

82%

7. Graegin Loan: Borrow from a family entity and deduct the loan interest from the taxable estate.

To have a formal discussion on the best way to plan for the payment of future estate taxes, these seven methods should be modeled on a spreadsheet allowing for significant variables. The following variables should be considered:

- Securities discount (assume death in a bull market with a 1% discount for cost of converting to cash; but also consider death in a poor market that forces liquidation at a 15%, 20%, or 30% discount).
- Illiquid Asset Discount: Discount of converting to cash in a good or poor market (ex: real estate).
- Bank Interest Rate: What is the Prime rate?
- Government AFR Interest Rate (in the 1970s the interest rate on the 14-year spread out of estate tax payments exceeded 10%). What will the interest rate be at the estate owner's death and up to 14 years after?
- Present Value Discount Rate for cash or conservative liquid investments (fixed income).
- Cost of Life Insurance: allow for inputting private premium finance interest or institutional premium finance interest as the "cost" rather than the premiums if financing is used.

This educational exercise and the team discussion that follows will generate a significant savings to the family solely because the issue is addressed prior to death. This is referred to as a proactive planning discussion and it commonly results in reducing the cost of paying estate taxes 40-80% for ultra-affluent clients, even those in their 80s. Exhibit 4 contains the comparative results for a 60-year-old female, where her estate would have only four of the seven options available. The life insurance being considered was private premium financing through a family company.

Conclusion & Observations

- Knowledge is power. Sharing with family advisors how life insurance can be utilized by ultra-affluent families to enhance their wealth and influence multi-generationally, without adversely impacting lifestyle or family cash flow needs today, creates opportunities heretofore not considered by the team and family office.
- Life insurance is not a transaction for this specialized class. Rather, it should be seen and modeled as a unique financial instrument that has preferential tax treatment.
- Life insurance is frequently acquired to protect family wealth from estate tax shrinkage more efficiently than any other alternative.
- Sometimes life insurance is used as an income tax planning strategy since the cash value grows income tax-free throughout the insured's lifetime, withdrawals can be made tax free during the insured's lifetime, and then the contract converts into increased income tax-free proceeds at death.
- Utilizing exclusive insurance products with proprietary pricing for ultra-high net worth individuals enhances performances and frequently causes family advisors to explore the strategy. They begin to ask, "what benefits does life insurance offer?"
- Because the plan into which life insurance may be added is generally quite complex, the insurance advisor should be innovative, credentialed, and experienced in law, tax planning, finance, and life insurance, because implementation can often be as challenging as designing the insurance plan and the payment arrangement.
- At this level of planning, life insurance is utilized only if it is integrated into other financial and wealth succession planning that is being, or has been, completed by the family. Models of premium source designs should be presented as alternatives with differing costs and risks, but each accomplishing the desired tax-favored cash accumulation pool, the desired tax-favored death benefit, or both.
- Life insurance is a unique planning strategy because it bolsters offensive planning to transfer and preserve wealth while acting defensively to protect wealth and wealth planning in uncertain economic times. ■

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