Selected Designs

Using Life Insurance

Pacific Life Insurance Company

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Life insurance is an important tool in a client's overall portfolio.

Note that the primary purpose of a life insurance policy is to provide death benefit protection to family members or co-business owners in the event of the insured's premature death.

How life insurance is owned and premiums paid may vary based on:

- Client's need for life insurance
- Overall planning objectives
- If a business or other entity is involved

This quick reference guide highlights how life insurance may be used in five areas:

- Business Succession Planning
- Charitable Planning
- Estate Planning
- Executive Compensation
- Qualified Plans

How The Guide Is Organized

This guide provides a grid-like format for each considered design that includes:

- Design
- Design Goal
- Summary
- Who Funds the Premium
- Who Owns the Policy
- Beneficiary
- Advantages
- Disadvantages
- Income Tax Ramifications
- Possible Cost Recovery

Although life insurance is not the sole funding vehicle available for many of the designs examined, it is assumed that life insurance is used for the purpose of this publication.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Cross-Purchase Buy-Sell	To create an exit strategy for business owners upon the occurrence of a triggering event (e.g., death, disability, retirement, etc.).	Policies owned on the lives of the other business owners are applied towards the purchase of the other participating business owners' business interests upon the occurrence of a triggering event.	Individual business owners	Individual business owners own policies on each other's lives
Family Buy-Sell	To pass a business from a business owner to a family member that is active in the business upon the business owner's death, disability or retirement.	The active family member purchases a life insurance policy on the business owner's life. The active family member will use the life insurance cash value or death benefit proceeds to purchase the business from the exiting business owner or his or her estate.	Active family member(s)	Active family member(s)
Insured-Controlled Cross-Purchase Buy-Sell	To create an exit strategy for business owners upon a triggering event (e.g., death, disability, retirement, etc.) using policies owned by the insureds on their own lives.	A life insurance policy owned by the insured on his or her life is used to fund a cross-purchase buy-sell. Under the terms of a split-dollar agreement, a non-insured business owner is endorsed a portion of or all of the death benefit proceeds in excess of the policy's cash value. The insured business owner and the endorsee must be partners in a bona fide partnership to avoid violating the transfer-for-value rule.	Insured business owner. The non-insured business owner must pay or report the Reportable Economic Benefit (REB) amount as taxable income.	Insured business owners each own a policy on his or her own life

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Possible Cost Recovery
Policyowner (business owner who owns the policy on another business owner's life)	Generally, there will be an increase in basis for the purchasing business owner(s). The policyowners have access to the policies' cash values.	Multiple policies are required when there are more than two business owners involved in the agreement. The cash value of the policies owned by a decedent business owner are includable in the decedent's estate. If structured improperly, the participants may violate the transfer-for-value rule.	Purchasing business owners receive a cost basis equal to their purchase price. There could be capital gains exposure for a non-deceased exiting business owner if the proceeds received exceed their basis in the business.	Yes, if the life insurance death benefit proceeds exceed the amount required for the cross-purchase.
Active family member(s)	If structured properly, the business may be passed to the active family member(s) without income or estate taxes. The purchase may provide income for the business owner's surviving spouse. The active family member(s) may receive a bonus or loan from the business to assist in making the premium payments.	The active family member(s) will have to pay the policy premiums. If the business owner does not have a surviving spouse at his or her death, the value of the business may be subject to estate taxes. The cash value of the policy is includable in the policyowner's estate.	The active family member(s) will receive basis in the business equal to the purchase price. There could be capital gains exposure for a non-deceased exiting business owner if the proceeds received exceed their basis in the stock.	Yes, if the life insurance death benefit proceeds exceed the amount required for the purchase.
The non-insured business owner up to the endorsement amount. The insured business owner's estate or a beneficiary designated by the insured receives the remainder.	The insured business owner retains control over his or her own policy including any available cash value. The purchasing business owner may receive an increase in basis in the business interest they acquire. If the buy-sell is no longer needed, the parties may terminate the split-dollar agreements and continue to own policies on their own lives.	The policyowner and the endorsee must be partners in a bona fide partnership to avoid violating the transfer-for-value rule. The interest in a policy owned by the insured business owner is includable in that insured's/business owner's estate. Payment of the Reportable Economic Benefit (REB) by the non-insured business owner is considered taxable income to the policyowner.	An increase in basis for the purchasing business owner is possible. There could be capital gains exposure for a non-deceased exiting owner if the proceeds received exceed their basis in the business. The non-insured business owner must pay or report the REB as taxable income. Payment of the REB by the non-insured business owner is considered taxable income to the policy owner.	Yes, if the life insurance death benefit proceeds exceed the amount required for the cross-purchase.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
One-Way Buy-Sell	To pass a business from a business owner to a key executive or group of key executives upon the business owner's death, disability, or retirement.	The key executive(s) purchases a life insurance policy on the business owner's life. The business may provide the key executive with a bonus or loan to assist with the premium payments. The key executive(s) may use the life insurance cash value or death benefit proceeds to purchase the business from the exiting business owner or his or her estate.	Executive(s)	Executive(s)
Entity Redemption Buy-Sell (Entity Purchase)	To create an exit strategy for business owners upon the occurrence of a triggering event (e.g., death, disability, retirement, etc.).	A life insurance policy owned by the business is used by the business to purchase a business owner's interest upon the occurrence of a triggering event.	Business	Business
Trusteed Cross-Purchase Buy-Sell	Effectuate a cross-purchase buy-sell using a trust or escrow agent to own and administer life insurance policies.	The trustee or escrow agent is named the owner and beneficiary of the cross-purchase participant's policies. At the death of one of the insureds, the trustee receives the policy death benefit proceeds and applies them towards the purchase of the decedent business owner's interest in the business. The trustee or agent then distributes the decedent's business interest on a pro-rata basis to the surviving owners.	Business Owners	Trust

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Possible Cost Recovery
Executive(s)	The proceeds from the sale may provide income for the business owner's family after his or her death. The executive(s) may access any available policy cash value for financial needs, including to assist with a lifetime buy-out.	The business owner must rely on the key executive(s) to actually purchase the business. The key executive(s) must pay the premiums for the life insurance policy or pay income tax on any bonus amounts received.	The executive(s) will receive basis in the business equal to the purchase price. Any bonus amounts paid to the executive(s) will be deductible for the business, subject to reasonable compensation limits, and income taxable to the executive.	Yes, if the life insurance death benefit proceeds exceed the amount required for the purchase.
Business	An Entity Redemption Plan is a simple strategy. The policy's premiums are paid by the business. The policy's cash value is an asset of the business. The business has access to the policy's cash value.	There is no basis increase for surviving C-Corp shareholders (but surviving owners of pass-through entities may receive at least a partial basis increase as a result of the receipt of the tax-free death proceeds by the business). The premium payments are a non-deductible expense for the business. The dividend equivalence rules may apply if the business is a C-Corporation. The business' creditors may make claims against the policy's cash value.	The premium payments are a non-deductible expense for the business. There could be capital gains exposure for a non-deceased exiting business owner if the proceeds received exceed their basis in the business.	Yes, if the life insurance death benefit proceeds exceed the amount required for the entity redemption.
Trust	The design reduces the number of policies required for a cross-purchase buy-sell.	The structure of a trusteed cross-purchase and the shifting of beneficial interests in the life insurance policies will often violate the transfer-for-value rule.	A basis increase for the purchasing business owners is possible. There could be capital gains exposure for a non-deceased exiting business owner if the proceeds received exceed their basis in the business.	Yes, if the life insurance death benefit proceeds exceed the amount required for the cross-purchase.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Wait-and-See Buy-Sell	To create an exit strategy for business owners upon the occurrence of a triggering event (e.g., death, disability, retirement, etc.).	A combination of an entity redemption and a cross-purchase buy-sell where both the business and the business owners could receive an opportunity to buy an exiting business owner's interest upon the occurrence of a triggering event.	Business owner(s) or business. The business owner(s) can loan money to business or make additional capital contributions to the business.	Business owner(s) and/or business
Employee Stock Ownership Plan (ESOP)	To provide an exit plan for businesses though an employee-owned business.	A qualified profit sharing plan that purchases S-Corporation or C-Corporation employer stock. The company either contributes or sells stock to the ESOP, which owns the stock for the benefit of the plan participants (the company employees) and gradually allocates the stock to the participants' retirement accounts. The company repurchases the stock from the ESOP in the future, "the put option," and may use key person life insurance to help fund this obligation.	Business	Business

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Estate Tax Ramifications
Business owner(s) or business (same as the policy owner)	The Wait-and-See Buy-Sell is a flexible strategy. There is a possible increase in basis for the remaining business owners.	The Wait-and-See Buy-Sell is a complex design. Multiple policies may be required when more than two business owners are involved in the agreement. If structured improperly, the participants may violate the transfer-for-value rule.	If the business redeems the shares, there may not be a basis increase for the remaining C-Corp shareholders (but remaining owners of pass-through entities may receive at least a partial basis increase if tax-free life insurance proceeds are paid to the business). There could be capital gains exposure for a non-deceased exiting business owner if the proceeds received exceed their basis in the business.	Yes, if the life insurance death benefit proceeds exceed the amount required for the purchase or redemption of the decedent's business interest.
Business	The ESOP provides a business succession plan for the business owner while while allowing employees the option of direct ownership in the company. The cash value of the business owned life insurance can be accessed by the business to purchase the ESOP shares of deceased or retiring ESOP participants.	An ESOP is a type of qualified plan, so the ESOP must comply with non-discrimination rules.	The contributions made by the company to the ESOP plan are income tax deductible; however, the life insurance premium payments are not tax-deductible for the business. The death benefit is generally received tax-free.*	The deceased business owner's remaining interest in the company is included in his or her estate.

* For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e. the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Charitable Gifts of Life Insurance - Donor as Owner and Charity as Beneficiary of a Life Insurance Policy	To benefit a charity at death but retain the ability, during the insured's lifetime, to take loans or cash withdrawals from a life insurance policy.	The donor/insured owns a life insurance policy and names the charity as the beneficiary. Upon the donor/insured's death, the death benefit proceeds are paid to the charity.	Donor/Insured	Donor/Insured
Charitable Gifts of Life Insurance - Donor Transfers an Existing Life Insurance Policy to Charity	To make a gift to the charity of life insurance death benefit proceeds and to potentially receive charitable income tax deductions for the contribution of an existing life insurance policy to a charity and for future life insurance premium payments.	The donor/insured donates an existing life insurance policy to the charity. The donor/insured may make future contributions to the charity so the charity may pay the premiums. Alternatively, the donor/insured may pay the premiums to the life insurance company. Upon the donor/insured's death, the death benefit proceeds are distributed to the charity.	The charity may use contributions from the donor/insured or the charity may use other resources to pay the premiums. Alternatively, the donor/insured may pay the premiums directly to the life insurance company.	Charity
IRA Bequest & Wealth Replacement Trust	To make a gift to the charity by leaving the balance of an IRA to a charity at death while receiving an estate tax deduction and leaving life insurance death benefit proceeds to heirs through an ILIT.	The IRA owner takes income taxable IRA distributions during life. The IRA Owner gifts the cash to an ILIT. These gifts may be subject to gift taxes depending on the owner's use of his or her annual exclusion gifting and/or lifetime gift tax exemption amount. The ILIT trustee purchases life insurance on the owner/insured's life. At the IRA owner/insured's death, the IRA passes to the designated charity and the ILIT receives the death benefit proceeds free from estate and income tax.*	ILIT	ILIT

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Estate Tax Ramifications
Charity	The donor/insured owns the life insurance policy. As a result, the donor/insured may take income tax-free* loans or cash withdrawals from the policy as a means to supplement his or her retirement.	The donor/insured does not receive charitable income tax deductions for premium payments. The death benefit provided to the charity should not exceed an amount that is equivalent to the donations that would be lost by the charity should the insured/donor die prior to life expectancy.	The donor/insured does not receive charitable income tax deductions for premium payments because the charity does not own the life insurance policy.	The life insurance death benefit proceeds are included in the donor/insured's taxable estate. The donor/insured's estate, however, may receive a corresponding charitable estate tax deduction because the death benefit proceeds will be paid to the charity.
Charity	Should the insured/donor die prematurely, the charity will receive a death benefit approximately equal to what the donor would have gifted to the charity had he or she lived to life expectancy.	The donor/insured may have to make additional gifts to the charity or premium payments to the life insurance company in order to keep the life insurance policy in force.	The donor/insured may receive charitable income tax deductions for gifts to the charity or for payment of premiums to the life insurance company on the policy owned by the charity.	The life insurance death benefit proceeds generally are not included in the donor/insured's taxable estate because the charity is the owner and beneficiary of the policy.
ILIT	The IRA owner/insured's estate should receive a charitable estate tax deduction for the IRA balance that passes to the charity. The life insurance death benefit proceeds "replace" the IRA assets that the owner/insured's heirs "lost" due to the charitable IRA bequest.	Depending on the size of the IRA, the IRA owner's distribution may not be able to purchase a sufficient amount of life insurance death benefit. If owner is under age 59½, distributions are subject to a 10% penalty.	Distributions from the IRA are subject to income taxation. Distributions prior to age 59½ may be subject to an additional 10% penalty.	If structured properly, the life insurance death benefit proceeds are not includable in the IRA owner/insured's taxable estate. Additionally, the IRA owner/insured's estate receives an estate tax deduction for the IRA balance left to charity.

* For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e. the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

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Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Private Foundation in Conjunction with a Wealth Replacement Strategy	To make a gift that can be carried on by future generations of your family while leaving a life insurance death benefit to heirs through an ILIT.	A private foundation is established during life or at death. Donating asset(s) to a private foundation disinherits the heirs who would have received the asset(s). By establishing an ILIT and purchasing a life insurance policy in the ILIT, it "replaces" the wealth lost to heirs.	ILIT	ILIT
Wealth Replacement Strategy Using a Charitable Remainder Trust with Life Insurance	To make a gift to the charity of the remainder interest in the Charitable Remainder Trust (CRT) while receiving an income stream from the CRT and leaving life insurance death benefit to heirs through an ILIT.	A CRT and an ILIT are established. The donor/insured transfers assets to the CRT and the CRT pays an income stream to the donor/insured. This stream of income may be gifted to the ILIT to pay premiums on an ILIT-owned life insurance policy for the benefit of the donor/insured's heirs. Upon the donor/insured's death, the remaining assets in the CRT are distributed to the charity and the death benefit proceeds are distributed to ILIT beneficiaries.	ILIT	ILIT

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Estate Tax Ramifications
ILIT	The death benefit proceeds inside the ILIT "replaces" the wealth that the donor/insured's beneficiaries have "lost" as a result of the private foundation.	Donating an asset to a private foundation disinherits the heirs who would have received the asset.	The donor/insured receives income tax deductions for lifetime contributions within certain limits depending on the type and amount of contribution. The purchase of life insurance by the ILIT should not produce taxable income.	Bequests to the private foundation at death are deductible for estate tax purposes. The life insurance death benefit proceeds are not included in the donor/insured's taxable estate because they are owned by an ILIT.
ILIT	The donor/insured receives a stream of income from the CRT. The death benefit proceeds inside the ILIT will "replace" the wealth that the donor/insured's beneficiaries have "lost" as a result of the CRT.	Depending on how the CRT is structured and how long the donor/insured lives, the income stream from the CRT may provide a small benefit to the donor/insured.	The donor/insured receives a charitable income tax deduction based on the calculated value of the gift to the charity. Also, no capital gains tax is paid upon the sale of the appreciated asset held in the CRT because a CRT is usually tax exempt.	At the end of the CRT term, the entire remaining value of the CRT passes to the designated charity and is outside of the donor/insured's taxable estate. The life insurance death benefit proceeds are not included in the donor/insured's taxable estate because they are owned by an ILIT.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Dynasty Trust	To leverage the Generation-Skipping Transfer (GST) tax exemption of the grantor/insured using a Dynasty Trust that will be the owner and beneficiary of a life insurance policy insuring the grantor/insured's life.	The grantor/insured creates a Dynasty Trust, a type of an irrevocable trust, for the benefit of future generations. GST tax exemption is allocated to the gifts made by the grantor to the Dynasty Trust. The trustee buys life insurance insuring the grantor/insured. After the death benefit is paid to the Dynasty Trust, distributions to beneficiaries should be free from estate tax and GST tax.	Dynasty Trust	Dynasty Trust
Estate Tax Liquidity using an Entity Redemption	To provide estate tax liquidity using life insurance without the need for advanced estate planning, such as creating an ILIT.	The business enters into an agreement to purchase part or all of a business owner's interest at his or her death. The business uses the death benefit proceeds to purchase the business interest from the estate (typically equal to the projected estate tax) providing liquidity to pay federal and/or state estate costs. Furthermore, the life insurance owned by the business should not be directly included in the insured's estate and it should not be indirectly included where the business owns life insurance that is intended to fulfill an obligation under a valid buy-sell agreement.	Business	Business

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Gift Tax Ramifications
Dynasty Trust	Potential leveraging of GST tax exemption of grantor/insured by providing life insurance death benefit free from estate tax and GST Tax to future generations.	Depending on state law, the rule against perpetuities may require the Dynasty Trust to terminate in the future. Also, the grantor/insured cannot serve as the trustee of the Dynasty Trust.	The purchase of life insurance by the Dynasty Trust should not produce taxable income.	The grantor/insured may avoid paying gift tax on gifts of premiums to the Dynasty Trust if such transfers can qualify as annual exclusion gifts. Alternatively, the lifetime gift tax exemption amount of grantor/insured may be used to fund the Dynasty Trust. The GST tax exemption of grantor should be allocated to all transfers to the Dynasty Trust.
Business	This involves less complexity than other estate planning techniques, eliminates gifting to trusts, and helps provide business continuity and liquidity for estate expenses while providing potentially estate-tax free life insurance proceeds.	A partial redemption of a C-Corporation shareholder could result in dividend treatment, unless the redemption is for the purpose of providing liquidity to pay federal estate taxes pursuant to IRC Sec. 303. Finally, the basis of the surviving owners will not increase after the redemption.	The death benefit should pay out to the business income tax-free and the business can access the available cash value through loans and withdrawals income tax-free.	There is no gifting involved in this strategy; however, if additional planning is needed (for example, additional life insurance policy is needed in an ILIT because the value of the business is insufficient to fulfill the redemption obligation) then gift taxes may be incurred to the extent the individual has exhausted his or her lifetime gift/estate tax exemption.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Grantor Retained Annuity Trust (GRAT) as a Rollout Strategy for a Premium Financing or Split-Dollar Arrangement	To fund the anticipated termination of a premium financing or split-dollar arrangement by providing a future transfer of wealth to an ILIT at a potentially reduced gift tax cost.	A GRAT is established after entering into a premium financing or split-dollar arrangement. Income producing and/or highly appreciating property is transferred to the GRAT and the grantor receives a stream of fixed annuity payments for a predetermined period of time. At the expiration of the GRAT term, if the grantor survives the term, any assets remaining in the GRAT pass to the ILIT as remainder beneficiary. The trustee of the ILIT uses the remainder interest to assist in the repayment of the loan.	ILIT	ILIT
Incentive Trust	To promote positive behaviors and reinforce the values the grantor/insured has instilled in heirs.	An Incentive Trust, a type of irrevocable trust that owns life insurance, is drafted to allow the trustee to make distributions according to provisions set forth in the document to encourage positive behavior and/or deter negative behavior.	Incentive Trust	Incentive Trust

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Gift Tax Ramifications
ILIT	A GRAT may minimize the grantor/insured's potential gift tax impact of contributions to fund the anticipated termination of a premium financing or split-dollar arrangement.	The assets transferred to the GRAT may not generate income and/or appreciate as planned. There may be insufficient assets distributed to the ILIT to repay the loan or terminate the split-dollar arrangement. If the grantor/insured does not outlive the GRAT term, the value of the remaining payments will be included in the grantor/insured's taxable estate. Life insurance should not be purchased inside the GRAT.	If the GRAT is drafted as a grantor trust for income tax purposes, each annuity payment from the GRAT to the grantor/insured is not subject to income tax. Any income generated by the GRAT, however, is taxed to the grantor if the GRAT is a grantor trust.	Based on, among other things, the term and the retained annuity stream of the GRAT, there may be little or no gift tax imposed at the time the GRAT is established.
Incentive Trust	The death benefit generally passes to the Incentive Trust estate tax-free. Inherited wealth may create a positive rather than a negative legacy. The choice of incentive provisions is only limited by the creativity of the grantor/insured and advisors.	The grantor/insured cannot serve as trustee of the Incentive Trust.	The purchase of life insurance by the Incentive Trust should not produce taxable income.	The grantor/insured may avoid paying gift tax on gifts to the Incentive Trust if such transfers can qualify as annual exclusion gifts. Alternatively, the lifetime gift tax exemption amount of grantor/insured may be used to fund the Incentive Trust.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Installment Sale to an Intentionally Defective Irrevocable Trust (IDIT Sale)	To transfer income generating and appreciating assets to younger generations at a reduced cost and to minimize the gift tax associated with funding a life insurance policy owned outside of the grantor/insured's taxable estate.	The grantor/insured sells income generating and appreciating assets to an IDIT in exchange for an installment note. Any income in excess of the note payments may be used by the IDIT to pay for life insurance premiums insuring the grantor/insured.	IDIT	IDIT
Irrevocable Life Insurance Trust (ILIT)	Death benefit amount of a life insurance policy owned outside of the grantor/insured's taxable estate not subject to estate taxes.	An ILIT that owns a life insurance policy is established to exclude the death benefit amount from the grantor's taxable estate.	ILIT	ILIT
ILIT Loans	Potential indirect access to the cash value of a life insurance policy owned outside of the grantor/insured's taxable estate.	An ILIT that owns a life insurance policy is drafted to allow the trustee, at his or her discretion, to make loans.	ILIT	ILIT

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Gift Tax Ramifications
IDIT	If the assets sold to the IDIT generate income and appreciate greater than the interest rate on the installment note, the excess income and appreciation is removed from the estate of grantor/insured without gift tax consequences. If IDIT funds are used to pay for the policy premiums, the grantor/insured does not need to fund a life insurance policy owned outside of the taxable estate. A policy insuring the grantor/insured is owned outside of the taxable estate without the creation of a separate ILIT.	The grantor/insured should gift at least 10% to 15% of the value of the assets sold to the IDIT to "seed" the trust before selling the asset to the IDIT. If assets owned by the IDIT do not generate sufficient income or depreciate, the IDIT may not have the cash necessary to pay the life insurance premiums.	The IDIT is defective for income tax purposes. Therefore, the income tax liability of the IDIT is paid by the grantor/insured. Also, if the IDIT is a grantor trust, any sale of assets to the IDIT should not produce income or capital gains tax for the grantor/insured.	The lifetime gift tax exemption amount of grantor may be used to fund the IDIT with the "seed money."
ILIT	The death benefit generally passes to the ILIT estate tax-free.	The grantor does not have unrestricted access to the policy's cash value. Also, the grantor/insured cannot serve as trustee of the ILIT.	The purchase of life insurance by the ILIT should not produce taxable income.	The grantor/insured may avoid paying gift tax on gifts to the ILIT if such transfers can qualify as annual exclusion gifts. Alternatively, the lifetime gift tax exemption amount of grantor/insured may be used to fund the ILIT.
ILIT	The death benefit generally passes to ILIT estate tax-free despite the grantor/insured's indirect access to the policy's cash value. Outstanding loans should be a bona fide debt of the estate that reduces the value of the grantor/insured's estate.	The grantor/insured must pay loan interest to the ILIT at least annually and post security for the loan. Also, the grantor/insured cannot serve as trustee of the ILIT.	Generally, if properly structured, distributions from the ILIT to the grantor/insured may be income tax-free. If the trust is drafted as a defective grantor trust for income tax purposes, the interest on the loan payable to the ILIT should not be subject to income tax.	The grantor/insured may avoid paying gift tax on gifts to the ILIT if such transfers can qualify as annual exclusion gifts. Alternatively, the lifetime gift tax exemption amount of grantor/insured may be used to fund the ILIT.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
ILIT-Owned Life Insurance Purchased with Employer-Provided Demand Loans	To reduce the gift tax costs associated with funding a life insurance policy owned outside of the executive's taxable estate.	The premiums for an ILIT-owned policy are paid using a demand loan from the employer. The executive can gift to the ILIT an amount that is sufficient to pay the loan interest or loan interest may be imputed in executive's income and be deemed a gift to the ILIT.	ILIT	ILIT with an amount equal to the loan balance assigned to the employer.
ILIT-Owned Life Insurance Purchased with Employer-Provided Term Loans	To reduce the gift tax costs associated with funding a life insurance policy owned outside of the executive's taxable estate.	The premiums for an ILIT-owned policy are paid using a term loan from the employer. The executive must gift an amount to the ILIT that is sufficient to pay the loan interest as the imputation of loan interest is prohibitively costly.	ILIT	ILIT with an amount equal to the loan balance assigned to the employer.

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Gift Tax Ramifications
ILIT	The employer helps pay the premiums for an ILIT-owned policy. The amount of the gifts to the ILIT may be reduced. The death benefit that is payable to the ILIT generally passes estate tax-free.	The loan interest rate will fluctuate in most cases. The ILIT may not be able to repay the employer the balance due on the note if the employer demands repayment of loan when the policy's cash value is less than loan balance. Repayment of the loan prior to death from a withdrawal or loan from the policy's cash value may significantly diminish the policy's death benefit. Inappropriate for a majority shareholder as the life insurance policy would be included in the majority shareholder's estate.	The ILIT must pay loan interest to the employer, or it will be imputed in the executive's taxable income and be deemed a gift to the trust. The receipt of loan interest by the business will be subject to income taxation.	The executive may avoid paying gift tax on gifts to the ILIT if such gifts qualify as annual exclusion gifts. Alternatively, the lifetime gift tax exemption amount of the executive may be used to fund the ILIT. Gifts of imputed income to the trust generally will not qualify for the annual gift tax exclusion.
ILIT	The employer helps pay the premiums for an ILIT-owned policy. The amount of the gifts to the ILIT may be reduced. The interest rate may be fixed for the loan term. The death benefit that is payable to the ILIT is generally passed estate tax-free.	The ILIT may not be able to repay the employer the balance due on the note if the policy's cash value is less than the loan balance at the end of the loan term. Repayment of the loan prior to death from a withdrawal or loan from the policy's cash value may significantly diminish the policy's death benefit.	The ILIT must pay loan interest to the employer because imputing the loan interest is prohibitively costly. The receipt of loan interest by the employer will be subject to income taxation.	The executive may avoid paying gift tax on gifts to the ILIT if such gifts qualify as annual exclusion gifts. Alternately, the lifetime gift tax exemption amount of the executive may be used to fund the ILIT.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Life Insurance for the Blended Family	To provide for both the current spouse as well as the children from a prior marriage.	In order to provide an equitable division of assets, the grantor/insured creates an Irrevocable Life Insurance Trust (ILIT) that owns a life insurance policy on the life of the spouse with children from a former marriage, for the benefit of those children. The ILIT-owned assets and life insurance policy may help provide the inheritance intended for them without having to wait until the death of the current spouse.	ILIT	ILIT
Maximizing B-Trust Assets	To maximize assets held inside the B-Trust for beneficiaries.	The B-Trust is established at the first spouse's death. If the surviving spouse does not need the income from the B-Trust, the income is used to buy life insurance on the surviving spouse's life.	B-Trust	B-Trust
Premium Financing	To reduce the costs associated with funding a life insurance policy owned outside of the grantor/insured's taxable estate.	An ILIT-owned policy is funded with loans from a third-party lender. The ILIT borrows money from a third-party lender to pay the life insurance premiums. The ILIT pays loan interest and collaterally assigns the policy to the lender.	ILIT	ILIT with a collateral assignment granted to the third-party lender.

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Gift Tax Ramifications
ILIT	The death benefit generally passes to the ILIT estate tax-free.	The grantor does not have unrestricted access to the policy's cash value. Also, the grantor/ insured cannot serve as trustee of the ILIT.	The purchase of life insurance by the ILIT should not produce taxable income.	The grantor/insured may avoid paying gift tax on gifts to the ILIT if such transfers can qualify as annual exclusion gifts. Alternatively, the lifetime gift tax exemption amount of grantor/insured may be used to fund the ILIT.
B-Trust	The death benefit from the life insurance policy may potentially maximize wealth to the beneficiaries of the B-Trust. The death benefit is outside of the surviving spouse's taxable estate without the creation of a separate ILIT.	The surviving spouse cannot serve as trustee of the B-Trust if the B-Trust purchases a life insurance policy on the life of the surviving spouse.	The purchase of life insurance by the B-Trust should not produce taxable income.	Generally, there are no gift tax consequences provided that the premium payments are made solely with assets from the B-Trust.
ILIT	A third-party lender provides the premiums to the ILIT so the grantor/ insured does not need to liquidate other investments to pay premiums. The grantor/insured gifts the loan interest – not the full premium amount – to the ILIT. By only gifting the loan interest to the ILIT, the grantor/insured's gifts to the ILIT may be reduced. The death benefit generally passes estate tax-free.	Repayment of the loan prior to death from a withdrawal or loan from the policy's cash value may significantly diminish the policy's death benefit. Qualifying for the loan for the premium payments in one year does not guarantee that the lender will lend funds for further premium payments. Similar to some other types of financing, credit worthiness may need to be established each year.	There are generally no income tax consequences as long as the policy is not a Modified Endowment Contract (MEC). Interest payments on the loan are not income tax deductible.	The grantor/insured may avoid paying gift tax on gifts to the ILIT if such gifts qualify as annual exclusion gifts. Alternatively, the lifetime gift tax exemption amount of the grantor/ insured may be used to fund the ILIT.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Private Financing: Intra-Family Loans	To reduce the gift tax associated with funding a life insurance policy owned outside of the insured's taxable estate.	An ILIT-owned policy is funded through loans from a private individual/lender. The grantor/insured may continue to may gifts to the ILIT. The trustee may use any available trust assets to pay the loan interest to the lender.	ILIT using loans from a private individual/lender.*	ILIT; private individual/lender obtains a collateral assignment over a portion of the death benefit and cash value equal to the loan balance.
Private Financing: Private Split-Dollar	To reduce the gift tax costs associated with funding a life insurance policy owned outside of the insured's taxable estate.	An ILIT-owned policy is funded pursuant to an arrangement between an ILIT and a private individual. The agreement requires the ILIT to pay premiums equal to the REB and the premium payor to pay the balance of the premium. The insured gifts funds to the ILIT; the ILIT may use those funds to pay the REB.	ILIT pays premiums equal to the REB and premium payor pays balance of the premium.	ILIT; premium payor is collaterally assigned an interest in the policy equal to the entire cash value.*
Spousal Lifetime Access Trust (SLAT)	Potential indirect access to the cash value of a life insurance policy owned inside of an irrevocable trust outside of the grantor/insured's taxable estate.	A SLAT that owns a life insurance policy is drafted to allow the trustee, at his or her discretion, to distribute the principal and/or income of the trust to the non-grantor spouse during his or her lifetime.	The grantor/insured uses his or her separate property to make gifts to the SLAT.	SLAT

* If the premium payor is also the insured, premium payor/insured is given a restricted collateral assignment over the entire cash value. The restricted collateral assignment limits the premium payor/insured's right to access the cash value of the policy.

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Gift Tax Ramifications
ILIT	The amount of the gifts to the ILIT may be reduced. The death benefit of the policy that pays to the ILIT generally passes estate tax-free.	The ILIT may not be able to repay the lender the balance due on the note if the policy's cash value is less than loan balance at the end of the loan term. Repayment of the loan prior to death from a withdrawal or loan from the policy's cash surrender value may significantly diminish the policy's death benefit. If the lender is also the insured, the amount payable to the insured in satisfaction of the note will be included in the insured's taxable estate.	The private individual/ lender's receipt of loan interest from the ILIT may be subject to income taxation unless the lender is the grantor of the ILIT and the ILIT is drafted as a defective grantor trust for income tax purposes.	The insured may avoid paying gift tax on gifts to the ILIT if such gifts qualify as annual exclusion gifts. Alternately, the lifetime gift tax exemption amount of the grantor may be used to fund the ILIT.
ILIT	The amount of the gifts to the ILIT may be reduced. The death benefit of the policy that pays to the ILIT generally passes estate tax-free.	At termination of the Private Split-Dollar arrangement, the premium payor should receive from the ILIT an amount equal to the cash value. Without proper planning, the policy may lapse if rollout occurs during the Insured's lifetime. If the premium payor is the insured, the cash value payable to the insured at termination will be includable in the insured's taxable estate.	The premium payor's receipt of REB from the ILIT may be subject to income taxation. Drafting the ILIT as a defective grantor trust for income tax purposes may avoid this income taxation.	The insured may avoid paying gift tax on gifts to the ILIT if such gifts qualify as annual exclusion gifts. Alternatively, the lifetime gift tax exemption amount of the insured may be used to fund the ILIT.
SLAT	The death benefit generally passes to the SLAT estate tax-free despite the grantor/ insured's indirect access to the policy's cash value.	The grantor/insured may lose potential indirect access to the policy's cash value if the non-grantor spouse dies or if there is a divorce. Also, the grantor/ insured cannot serve as trustee of the SLAT.	Generally, if properly structured, distributions from the SLAT to the non-grantor spouse may be income tax-free.	The grantor/insured may avoid paying gift tax on gifts to the SLAT if such transfers can qualify as annual exclusion gifts. Alternatively, the grantor's/ insured's lifetime gift tax exemption amount may be used to fund the SLAT.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Supplemental Executive Retirement Plan (SERP) (Defined Benefit Type)	To provide supplemental income for the executive at retirement.	The business informally funds a non-qualified plan beyond the qualified plan limits to promote loyalty and provide the executive with an agreed upon benefit at retirement. The benefits can be subject to a vesting schedule. The business may use a key person life insurance policy to informally fund the plan.	Business	Business
Supplemental Executive Retirement Plan (SERP) (Defined Contribution Type)	To provide supplemental income for the executive at retirement.	The business informally funds an agreed upon amount into a non-qualified plan beyond the qualified plan limits to promote loyalty and provide the executive with supplemental income upon retirement. The account balance can be subject to a vesting schedule. The business may use a key person life insurance policy to informally fund the plan.	Business	Business
Voluntary Salary Deferral Plan	To permit the executive to defer income beyond the qualified plan limits without taxation to the executive, until retirement or another specified date.	The executive defers salary to provide supplemental income upon retirement or another specified date. The business may use a key person life insurance policy to informally fund the plan.	Business (using the executive's deferral as the source of the premiums)	Business

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Possible Cost Recovery
Business	The business may discriminate within its ERISA top-hat group. As a non-qualified plan, there are no limits on the contributions to the plan. Contributions to a SERP are made solely by the business.	Like other assets used to informally fund a non-qualified plan, the policy's cash value is subject to the business' creditors. Must be limited to ERISA top-hat executives. There is no deduction for the business until actual or constructive receipt of the retirement benefit by the executive. The business bears the market risk of the vehicle used to informally fund the liability.	The executive's tax on the income is deferred until actually or constructively received. The business' deduction cannot be taken until actual or constructive receipt by the executive.	Yes
Business	The business may discriminate within its ERISA top-hat group. As a non-qualified plan, there are no limits on the contributions to the plan. Contributions to a SERP are made solely by the business.	Like other assets used to informally fund a non-qualified plan, the policy's cash value is subject to the business' creditors. Must be limited to ERISA top-hat executives. There is no deduction for the business until actual or constructive receipt of the account balance by the executive.	The executive's tax on the supplemental income is deferred until actually or constructively received. The business' deduction cannot be taken until actual or constructive receipt by the executive.	Yes
Business	The business may discriminate within its ERISA top-hat group. As a non-qualified plan, there are no limits on the contributions to the plan.	Like other assets used to informally fund a non-qualified plan, the policy's cash value is subject to the business' creditors. Must be limited to ERISA top-hat executives. There is no deduction for the business until actual or constructive receipt of the account balance by the executive.	The executive's tax on the income is deferred until actually or constructively received. The business' deduction cannot be taken until actual or constructive receipt by the executive.	Yes

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
401(k) Overlay/Mirror Plan	To permit the executive to defer income and the business to match the deferrals beyond the qualified plan limits without taxation to the executive, until retirement or some other specified date.	The executive defers salary and the business may match to provide supplemental income to the executive upon retirement or some other specified date. The business matches may be subject to a vesting schedule. The business may use a key person life insurance policy to informally fund the plan.	Business (using the executive's deferral as a partial source of the premiums)	Business
Death Benefit Only Salary Continuation Plan	To provide income to the executive's beneficiaries after the executive's death.	The business provides income to the executive's beneficiaries after the executive's death using life insurance death benefit proceeds.	Business	Business
Deferred Compensation for Non-Profit Organizations Eligible 457(b) Plan	To provide supplemental income for the executive of a non-profit organization at retirement.	The executive defers compensation beyond the qualified plan limits (voluntary deferrals and/or business contributions/matches) to provide supplemental income. The deferrals and/or contributions are limited to the annual applicable dollar limit. The business' contributions may be subject to a vesting schedule. The business may use a key person life insurance policy to informally fund the plan.	Business (in many cases, an executive's deferral will be a source of the premiums)	Business
Deferred Compensation for Non-Profit Organizations Ineligible 457(f) Plan	To provide supplemental retirement income to the executive of a non-profit organization beyond the qualified plan limits without taxation until retirement or some other specified date.	The business funds an agreed upon amount into a nonqualified plan beyond the qualified plan limits to promote loyalty and provide the executive with supplemental income upon retirement. The taxation of the plan balance will occur when a substantial risk of forfeiture no longer exists. The business may use a key person life insurance policy to informally fund the plan.	Business	Business

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Possible Cost Recovery
Business	The business may discriminate within its ERISA top-hat group. As a non-qualified plan, there are no limits on the contributions to the plan.	Like other assets used to informally fund a non-qualified plan, the policy's cash value is subject to the business' creditors. Must be limited to ERISA top-hat executives. There is no deduction for the business until actual or constructive receipt of the retirement balance by the executive.	The executive's tax on the income is deferred until actually or constructively received. The business' deduction cannot be taken until actual or constructive receipt by the executive.	Yes
Business	The business may discriminate within its ERISA top-hat group. Provides supplemental income to the executive's beneficiaries after the executive's death.	The business' deduction is not allowed until the benefits are actually paid to the executive's beneficiaries.	The payments to the beneficiaries are generally deductible for the business. The deduction is subject to the reasonable compensation limits for past services rendered by the executive. The payments are ordinary income for the beneficiaries.	Yes
Business	The business may discriminate within its ERISA top-hat group.	Like other assets used to informally fund a non-qualified plan, the policy's cash value is subject to the business' creditors. Must be limited to ERISA top-hat executives. Contributions in excess of the annual applicable dollar limit are subject to IRC Section 457(f). A governmental 457(b) plan may not use a life insurance policy as the informal funding vehicle for the plan.	The executive's tax on the income is deferred until actually or constructively received.	Yes
Business	The business may discriminate within its ERISA top-hat group. As a nonqualified plan, there are no limits on the contributions to the plan.	Like other assets used to informally fund a non-qualified plan, the policy's cash value is subject to the business' creditors. Must be limited to ERISA top-hat executives. A substantial risk of forfeiture must exist or lump sum taxation to the executive on the plan balance will occur.	The executive's tax on the income is deferred until actually or constructively received (assuming there is a substantial risk of forfeiture). Potential 21% excise tax to the non-profit under IRC Sec. 4960 of amount over $1 million received by the executive, if one of five most highly compensated.	Yes

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Endorsement Split-Dollar	To provide life insurance protection at a minimal or shared cost to the executive.	The executive is endorsed a portion of the death benefit of a policy owned by the business.	Business	Business
Nonequity Collateral Assignment Split-Dollar	To pay the premiums for an executive-owned policy with the business' dollars secured by the policy's cash value and a portion of the death benefit.	The business' interest in the executive-owned policy is secured by a collateral assignment of the policy's cash value and a portion of the death benefit.	Business	Executive
ILIT-Owned Nonequity Collateral Assignment Split-Dollar	To pay the premiums for an ILIT-owned policy with the business' dollars secured by the policy's cash value and a portion of the death benefit, providing potential gift and estate tax savings.	The business' interest in the ILIT-owned policy is secured by a collateral assignment of the policy's cash value and a portion of the death benefit.	Business	Irrevocable Life Insurance Trust (ILIT)
Key Person Life Insurance	To provide funds to a business to compensate for the loss of a key executive.	The business purchases a life insurance policy on a key executive. If the executive dies while the business owns the policy, the business, generally, will receive the policy death benefit income tax-free.*	Business	Business

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Possible Cost Recovery
Named by the executive up to the endorsement amount. The business is the beneficiary of any death benefit in excess of the endorsement.	Provides the executive with life insurance coverage for a minimal cost. The business has control over the policy and may access the cash value.	The policy is not portable for the executive. The executive does not have access to the policy's cash values.	The executive must pay or report the REB. The payment of the REB by the executive is income to the business.	Yes
Named by the executive to the extent of death benefit in excess of cash value. The business is the beneficiary to the extent of its interest in the policy.	The business may secure the policy's cash value through a collateral assignment. Provides life insurance coverage to the executive at a minimal cost.	The REB cost increases each year and may become prohibitive at older ages.	The executive must pay or report the REB. The payment of the REB by the executive is income to the business.	Yes
The ILIT is the beneficiary of the death benefit in excess of cash value. The business is the beneficiary to the extent of its interest in the policy.	Provides life insurance to the executive at a minimal cost. The death benefit that passes to the ILIT may be estate and income tax-free.*	The REB cost increases each year and may become prohibitive at older ages.	The ILIT must pay the REB amount annually. The payment of the REB by the ILIT is taxable income to the business.	Yes
Business	The business has access to the policy's cash value. A key person life insurance policy may help to keep the business solvent after the loss of a key executive.	The premiums must be paid with after-tax dollars. The business' creditors may make claims against the policy's cash value.	The premium payments are not an income tax deduction for the business. The death benefit is generally received tax-free*	Yes

* For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e. the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Executive Bonus	To pay the premiums for an executive-owned life insurance policy with the business' dollars.	The business provides a taxable bonus to the executive. The executive will use the after-tax bonus amount to make life insurance premium payments.	Executive (through employer-provided bonuses)	Executive
Restricted Executive Bonus	To pay the premiums for an executive-owned life insurance policy with the business' dollars while creating "golden handcuffs" to retain a key executive.	The business provides a taxable bonus to the executive. The executive will use the after-tax bonus amount to make life insurance premium payments. A direction form is filed with the policy which states the exercise of all policy ownership rights (except for beneficiary designation) requires the signature of both the executive and the business.	Executive (through employer-provided bonuses)	Executive

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Possible Cost Recovery
Named by the owner	The Executive Bonus is a simple design. Generally, the business may deduct the premium amounts as compensation to the executive. The policy is portable for the executive.	The bonus payments are taxable to the executive. The business has no control over the funds once the bonus is given. If the executive leaves the company, the executive is responsible for the future premium payments out of his or her own pocket. There may not be a tax advantage for owners of pass-through entities as they will receive the deduction and the taxation of the bonus. Additionally, for S-corporation owners, it may be more advantageous to take K-1 distributions rather than W-2 bonuses (due to payroll taxes).	Generally, the bonus is a deduction for the business. The bonus is considered taxable compensation for the executive.	No
Named by the owner	The Restricted Executive Bonus is a simple design. The business generally may deduct premium amounts as compensation to the executive. The Restricted Executive Bonus creates an incentive for the executive to stay with the business.	The bonus payments are taxable to the executive. If the executive leaves the business, the executive may be responsible for the future premium payments out of his or her own pocket.	Generally, the bonus is a deduction for the business. The bonus is considered taxable compensation for the executive.	No

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Forfeitable Restricted Executive Bonus	To pay the premiums for an executive-owned life insurance policy with the business' dollars while creating "golden handcuffs" to retain a key executive and maintaining the potential ability to recover its costs.	The business provides a taxable bonus to the executive. The executive will use the after-tax bonus amount to make life insurance premium payments. A direction form is filed with the policy which states the exercise of all policy ownership rights (except for beneficiary designation) requires the signature of both the executive and the business. The business and executive enter into an agreement that may require the executive to repay the bonuses.	Executive (through employer-provided bonuses)	Executive
Split-Premium Bonus	To provide a portion of the premium payments for an executive-owned life insurance policy using a combination of business dollars and the executive's personal funds.	The executive business provides a taxable bonus to the executive. The executive will use after-tax bonus and after-tax personal funds to make life insurance premium payments.	The Business and the Executive	Executive

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Possible Cost Recovery
Named by the owner	The business generally may deduct premium amounts as compensation to the executive. The Forfeitable Restricted Executive Bonus creates an incentive for the executive to stay with the business. The business may be able to recoup the bonuses if the executive leaves the business before the specified period of years.	The bonus payments are taxable to the executive. If the executive leaves the business, the executive may be responsible for the future premium payments out of his or her own pocket. If the executive is required to repay all or a portion of the bonuses to the business, the policy's cash value may be insufficient to make the full repayment.	In some cases the bonus may be a deduction for the business. The employment agreement calling for potential repayment of the bonus amounts may jeopardize the business' ability to take an upfront deduction. The bonus is considered taxable compensation for the executive. If the executive repays all or a portion of the bonuses, the executive may or may not receive a tax deduction or tax credit for the repayment.	Yes
Named by the owner	The business may choose which employees may participate. It is more cost efficient for the business as it is only paying for a portion of the premiums. Moreover, the business receives an up-front deduction for its portion of the premiums paid. The business may encourage employee retention by providing the key employees with a bonus that may be used for a cash value life insurance policy, which provides family protection and potential supplemental retirement income for the key employee.	The bonus payments are taxable to the key employee.	The business may receive an up-front income tax deduction for the reasonable bonus that is being used to pay a portion of the premium and the employee must pay taxes at his or her ordinary income tax level on the bonus that is received.	No

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
401(k) Plan	Provide retirement funds.	The employee defers salary (a maximum of $19,500 in 2021) on a pre-tax basis. The business may match deferrals and make elective contributions up to the lesser of $58,000 (in 2021) or 100% of compensation. Plan must provide for the purchase of life insurance. Employee would elect to pay life insurance premiums with pre-tax money.	The qualified plan, by using funds from the participant's account.	The qualified plan
Cash Balance Plan	Provide retirement funds in excess of what may be offered solely by a defined contribution plan.	Often called "hybrid plans," cash balance plans resemble a defined contribution plan in that the benefits are based on (and communicated to plan participants) as an account balance. But like a defined benefit plan, future retirement income is based on plan guarantees of account values. The participants' benefits in a cash balance plan grow at a guaranteed crediting rate and are not dependent on the plan's investment performance. The typical retirement benefit from a cash balance plan is a percentage of the participant's annual compensation and can be as much as $230,000 a year (in 2021).	The qualified plan, by using funds from the participant's account.	The qualified plan

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Estate Tax Ramifications
The qualified plan. The participant instructs the trustee, in writing, to pay the death benefit to his or her beneficiaries.	The life insurance premiums are paid with pre-tax money. The 401(k) account balance grows income tax-deferred.	In-service distributions from the plan are limited. Deferrals and contributions are also limited. The amount of life insurance protection that may be purchased inside the plan is limited by the incidental death benefit rules.	Distributions from a qualified plan are income taxable. A penalty of 10% may be assessed if the distribution occurs before age 59½. The participant must report the cost of current life insurance protection as taxable income when life insurance is held inside the plan.	The 401(k) account balance, including any life insurance death benefit, is includable in the participant's estate.
The qualified plan. The participant instructs the trustee, in writing, to pay the death benefit to his or her beneficiaries.	The contributions to the plan are tax-deductible for the sponsoring business. Furthermore, the plan may provide benefits in excess of what can be provided through a defined contribution plan. When used in conjunction with a 401(k) profit-sharing plan, a significant percentage of the contributions to the cash balance plan may be utilized for the benefit of the business owner.	All benefits provided by the cash balance plan must be provided on a non-discriminatory basis. The amount of life insurance protection that may be offered in the cash balance plan is limited by the incidental death benefit rules.	Distributions from a qualified plan are income taxable. A penalty of 10% may be assessed if the distribution occurs before age 59½. The participant must report the cost of current life insurance protection as taxable income when life insurance is held inside the plan.	The account balance, including any life insurance, is includable in the participant's estate.

Design	Design Goal	Summary	Who Funds the Premiums	Who Owns the Policy
Profit-Sharing Plan	Provide retirement funds.	The business makes discretionary contributions limited to a maximum of $58,000 (in 2021) or 100% of compensation a year. Contributions may be irrespective of any actual profits. Plan must provide for the purchase of life insurance. Employee would elect to pay life insurance premiums with pre-tax money.	The qualified plan, by using funds from the participant's account.	The qualified plan
Qualified Combo Plan	Provide larger retirement benefit than may be provided by defined contribution plan for business owners and death benefit protection for the business owner's family.	Business makes deductible contributions to both a 401(k) profit-sharing plan and split-funded defined benefit plan to fund investment choices and an "incidental amount" of life insurance. Business promises to provide the participants of the split-funded defined benefit plan an annual benefit at retirement, limited to the lesser of $230,000 (in 2021) or 100% of compensation per year, or a lump sum payment calculated by the third-party administrator.	Either the 401(k) profit-sharing plan, using funds from the participant's account, or split-funded defined benefit plan, using general trust funds. There are no separate accounts in defined benefit plans.	Either or both the 401(k) profit-sharing plan and/or split-funded defined benefit plan.
Split-Funded Defined Benefit Plan	Provide a larger retirement benefit than may be provided by a defined contribution plan for older participants and death benefit protection for participant's family.	Business makes deductible contributions to the plan to fund investment choices and an "incidental amount" of life insurance. Plan may provide for the purchase of life insurance. Business promises to provide an annual benefit at retirement, limited to the lesser of $230,000 (in 2021) or 100% of compensation per year, or a lump sum payment calculated by the third-party administrator.	The qualified plan, by using general trust funds. There are no separate accounts in defined benefit plans.	The qualified plan

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Beneficiary	Advantages	Disadvantages	Income Tax Ramifications	Estate Tax Ramifications
The qualified plan. The participant instructs the trustee, in writing, to pay the death benefit to his or her beneficiaries.	The life insurance premiums are paid with pre-tax money. Profit-sharing plans are the only type of qualified plan that may allow the purchase of survivorship life insurance. The use of seasoned money may increase the amount of insurance held in the plan. Profit-sharing plans have more flexible in-service distributions.	As with most defined contribution plans, contributions are currently limited to $58,000 (in 2021) per year. Contributions may vary from year to year and may be insufficient to maintain a life insurance policy. The plan cannot continue to hold the life insurance once the employee has separated from service.	Distributions from a qualified plan are income taxable. A penalty of 10% may be assessed if the distribution occurs before age 59½. The participant must report the cost of current life insurance protection as taxable income when life insurance is held inside the plan.	The account balance, including any life insurance, is includable in the participant's estate.
The qualified plan that owns the life insurance policy. The participant instructs the trustee, in writing, to pay the death benefit to his or her beneficiaries.	Cross-testing provisions may allow business owners to implement a split-funded defined benefit plan primarily for themselves and maintain a profit-sharing plan for their employees. Life insurance policy inside the plan provides a survivor benefit to the participant's heirs at a cost to the participant that is potentially less than the full premiums.	The business is responsible for funding the promised benefit. The plan must be non-discriminatory. Defined benefit plans have complex minimum funding requirements which require a plan actuary.	Distributions from a qualified plan are income taxable. A penalty of 10% may be assessed if the distribution occurs before age 59½. The participant must report the cost of current life insurance protection as taxable income when life insurance is held inside the plan. Contributions to both qualified plans are deductible to the business.	The account balance, including any life insurance, is includable in the participant's estate.
The qualified plan. The participant instructs the trustee, in writing, to pay the death benefit to his or her beneficiaries.	Life insurance inside the plan is funded with pre-tax money and provides a survivor benefit to participant's heirs. Including life insurance in the plan may increase the permissible deductible contribution by the business.	The business is responsible for funding the promised benefit. The plan must be non-discriminatory. Defined benefit plans have complex minimum funding requirements which require a plan actuary.	Distributions from a qualified plan are income taxable. The participant is taxed on the cost of current life insurance protection and assuming the participant reported the cost of current life insurance protection as income, the participant's heirs should receive a portion of the death benefit proceeds income tax-free.* Contributions to the plan are deductible to the business.	The account balance, including any life insurance, is includable in the participant's estate.

* For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e. the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

Charitable Income Tax Deductions

The maximum annual charitable income tax deduction for gifts of cash is either 60% of the donor's adjusted gross income (AGI) to public charities (although for 2020 and 2021, it may be 100% of the donor's AGI for gifts of cash to public charities) or 30% of the donor's AGI to private charities. The maximum annual charitable income tax deduction for gifts of life insurance is either 30% of AGI to public charities or 20% of AGI to private charities. For gifts of an existing life insurance policy to charity, the charitable deduction will be limited to the lesser of the donor's cost basis in the policy or the fair market value. IRC Sec. 170(b)(1)(A); IRC Sec. 170(b)(1)(B). For a life insurance policy owned by a charity, there is some question as to whether a payment made directly to the insurance company would be considered a gift "to" or "for the use of" charity. If the gift is considered "to" a public charity, the donor's deduction would be limited to 50% of the donor's AGI; if the gift is considered "for the use of" a public charity, the donor's deduction would be limited to 30% of the donor's AGI. If the gift is considered "to" or "for the use of" a private charity, the donor's deduction would be limited to 30% of the donor's AGI. Additionally, to purchase life insurance on the lives of their donors, charities must have an insurable interest. Most states have enacted laws giving charitable organizations an insurable interest in a donor. However, before creating a charitable insurance strategy, applicable state and federal law should be consulted.

Given that the rules regarding charitable income tax deductions are complex, the client's tax and/or legal advisors should be consulted to determine the amount of the deduction.

Company-Owned Life Insurance (COLI)

In accordance with existing and pending state insurable interest laws, an employer does not have an insurable interest in an employee unless certain conditions are met. Failure to satisfy state insurable interest requirements may result in disqualification of the policy as "life insurance" under IRC Sec. 7702, and also may, among other things, void the policy. For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

Death Benefits

For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

Deceased Shareholder's Estate

A deceased shareholder's estate can receive a step-up in basis in the decedent's business interest, which may reduce or eliminate capital gains exposure for the heirs.

Dividends

Dividends are the most common type of distribution from a corporation. They are paid out of the earnings and profits of the corporation. Dividends can either be classified as ordinary or qualified. Whereas ordinary dividends are taxable as ordinary income, qualified dividends that meet certain requirements are currently taxed at lower capital gain rates.

Dynasty Trust

A Dynasty Trust is oftentimes also referred to as a Generation Skipping Transfer Trust, and is intended to remain in existence for multiple generations of a family.

ERISA

The client's employee benefits legal counsel should be consulted to determine whether an arrangement is an employee benefit plan under the Employee Retirement Income Security Act of 1974 (ERISA) and, if so, whether any additional requirements are necessary to comply with ERISA.

Estate, Gift, and Generation-Skipping Transfer Taxes

If an insured has any incidents of ownership of the life insurance policy at the time of his or her death, or within three years of his or her death, or the proceeds are payable to or for the benefit of the insured's estate, the death benefit will be includable in his or her gross estate and may be subject to federal estate tax and/or state inheritance tax. IRC Secs. 2035 and 2042. According to the Tax Cuts and Jobs Act of 2017, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are all $10,000,000 per person (indexed for inflation effective for tax years after 2011); the maximum estate, gift and GST tax rates are 40%. In 2026, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are scheduled to revert to $5,000,000 per person (indexed for inflation for tax years after 2011).

Executive Bonus, Restricted Executive Bonus, Split-Premium Bonus and Forfeitable Restricted Executive Bonus

The deductibility of the bonus is subject to the reasonable compensation limits established by IRC Sec. 162(a).

Financial Underwriting

As with all uses of life insurance, the amount of life insurance coverage asked for in conjunction with this concept may be limited by Pacific Life Insurance Company's financial underwriting guidelines. Financial underwriting is an assessment of whether the proposed death benefit is a reasonable replacement for the financial loss caused by the death of the insured.

IRC Section 101(j)

For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

IRC Section 409A

Employers who establish non-qualified deferred compensation plans that contain amounts earned or vested after December 31, 2004 must comply with IRC Sec. 409A. If a non-qualified deferred compensation plan fails to meet IRC Sec. 409A's requirements, then all compensation deferred under the plan that is subject to IRC Sec. 409A for the current tax year and all preceding tax years is includible in the participants' income in the current tax year (with a 20 percent tax penalty and potential interest) to the extent that the amounts are not subject to a substantial risk of forfeiture and not previously included in the participants' gross income.

Married Couples

In U.S. v. Windsor, the Supreme Court of the United States held that the Defense of Marriage Act (DOMA) provision that defined marriage between a man and woman was unconstitutional. Subsequently, the US Department of Treasury and the Internal Revenue Service issued a revenue ruling affirming the Windsor decision. Revenue Ruling 2013-17 states that on September 16, 2013 individuals of the same-sex will be considered lawfully married under the Internal Revenue Code as long as they are married in a state or foreign jurisdiction that recognizes a same-sex marriage even if they are domiciled in a state that does not recognize the validity of same-sex marriages. In Obergefell v. Hodges the Supreme Court struck down all bans of same sex marriages in all states and in 2016, the IRS and Treasury issued regulation section 301.7701-18 that defined the terms spouse, husband, and wife to mean any individual lawfully married to another individual.

Modified Endowment Contract (MEC)

A MEC is any life insurance policy (issued on or after June 21, 1988) that fails the 7-Pay Test. This happens if the cumulative premiums paid during "the first seven contract years" exceed the amount needed to "pay up" the policy in seven (7) level annual payments, under IRC Sec. 7702A. The level annual premium needed to pay up the policy in seven years (the 7-Pay Premium) is determined in a manner similar to the calculations in the cash value accumulation test discussed in the Tax Definition of Life Insurance section on the following page. To avoid a policy becoming a MEC, the cumulative premiums paid cannot exceed the cumulative 7-Pay Premium limitation during "the first seven contract years." However, in any year where the premium paid was less than the 7-pay premium, the difference can be paid in a subsequent year.

Policy Loans

Assuming the life insurance policy is not a MEC as described on the previous page, policy loans from a life insurance policy are not treated as withdrawals or distributions and are not subject to income tax. IRC Sec. 7702(f).

If a life insurance policy loan is still outstanding when a policy is surrendered or lapses, the loan is automatically repaid from the cash value of the policy. This may result in taxable income to the extent the net surrender value plus the amount of the repaid loan exceeds the cost basis of the policy.

If a life insurance policy loan is still outstanding at the time of death, the loan is automatically repaid from the policy's death benefit. This use of the death benefit to repay a policy loan does not cause the recognition of taxable income.

Premium Financing

Premium financing is a premium payment option and may not be suitable for all of the advanced designs strategies.

Qualified Plans With Life Insurance

For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j). Per Treas. Reg. Sec. 1.72-16(c)(2)(iv), if the participant included the cost of life insurance protection as taxable income, a portion of the death benefit proceeds (that amount above the cash value) is treated as excludable benefits under IRC Sec. 101(a)(1).

Reportable Economic Benefit

Final Split Dollar Regulations (Treas. Reg. Sec. 1.61-22(d)(3)(ii)) reserved the issue of the cost of current life insurance protection for future guidance. Until such guidance is issued, Notice 2002-8 states that taxpayers may continue to use the insurance carrier's published one year term rates or the Table 2001 rates for arrangements entered into prior to January 28, 2002. For arrangements entered into after that date, taxpayers are generally limited to the Table 2001 rates unless the carrier's one year term rates are made known to all purchasers of term insurance from that carrier and are regularly sold.

Split-Dollar

Split-Dollar arrangements may be affected by the Sarbanes-Oxley Act of 2002 which prohibits personal loans by public companies to their directors and executive officers. Additionally, final split-dollar regulations have been adopted by the IRS that may impact the taxation of split-dollar arrangements entered into after September 17, 2003 in many circumstances. The client's tax and legal advisors should be consulted for further guidance.

Split-Dollar and Intra-Family Loans

Treas. Reg. Sec. 1.7872-15(d) treats non-recourse split-dollar loan arrangements as "contingent." If a split-dollar loan is treated as "contingent," it will generally result in the imposition of unfavorable assumptions when testing the loan for sufficient interest. Treas. Reg. Sec. 1.7872-15(d)(2)(i) provides an exception to this treatment if the parties to the split-dollar life insurance arrangement represent in writing that a reasonable person would expect that all payments under the loan will be made. Please contact your tax and legal advisors for further guidance.

Tax-Deferred Growth of Cash Values

Annual increases in the cash value of a life insurance policy are taxable only upon withdrawal, surrender, or other distribution. Cohen v. Comm., 39 TC 1055 (1963), acq. 1964-1 CB 4; IRC Sec. 72; IRC Sec. 7702(g).

Tax Definition of Life Insurance

A policy will qualify as life insurance under IRC Sec. 7702 if the policy qualifies as life insurance under applicable state law and meets one of two alternative tests: (1) the cash value accumulation test; or, (2) the guideline premium test. The guideline premium test requires that the sum of premiums paid reduced by non-taxable Withdrawals at any time does not exceed the guideline premium test Limit. The guideline premium test Limit is the greater of the guideline single premium or the sum of the guideline level premiums at such time, and the death benefit payable under the policy at any time is at least equal to an applicable percentage of the cash surrender value (the "cash value corridor test"). The cash value accumulation test requires that the cash surrender value of the policy does not at any time exceed the net single premium which would be necessary to fund future benefits under the policy. Failure to qualify as life insurance will result in taxation of all cash value increases, and only the excess of the death benefit over the net surrender value will be excludable from the income of the beneficiary as a death benefit.

Tax-Free Income

For federal income tax purposes, tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death (any outstanding policy debt at time of lapse or surrender that exceeds the tax basis will be subject to tax); (3) withdrawals taken during the first 15 policy years do not cause, occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC §§ 72, 7702(f)(7)(B), 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.

Trustee

The trustee appointed should not be the insured or the insured's life insurance producer. A life insurance producer who is paid a commission on the sale of a life insurance policy represents both his or her personal interest and the interests of the trust, creating a conflict of interest.

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PACIFIC LIFE

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Please Note: This brochure is designed to provide introductory information in regard to the subject matter covered.

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