



Advanced Markets

Planning in Action

Implementing a GRAT into Insurance Planning

Case in point

An agent called into Advanced Markets to discuss their clients, a high-net-worth couple who have been working with their attorneys to implement wealth-transfer strategies. In the past, the clients have used Grantor Retained Annuity Trusts (GRATs) to transfer assets out of their taxable estate to their children. The clients continue to have an estate tax issue, however, and want options to fund a \$10M life insurance policy. The agent asked our team if there are any strategies combining the use of GRATs with the purchase of life insurance. The short answer is “yes,” and the following discussion demonstrates how GRATs can be used with the purchase of life insurance to reduce or eliminate transfer tax exposure. .

Designing a case

The clients want to 1) minimize future estate growth and 2) fund a \$10M John Hancock Protection Survivorship Indexed UL (Protection SIUL) policy in an Irrevocable Life Insurance Trust (ILIT). The projected annual premium is \$144,303 (Vitality Bronze, 5.14% assumed crediting rate, death benefit guarantee 28 years). They are looking for sophisticated options to fund the ILIT and preserve their lifetime gift and estate tax exemption. (Over 28 years, if the client simply gifted the premium directly, total gifts would be **\$4,040,484**.)

To help address the life insurance funding need and gift tax concerns, the planning team presented four alternative techniques that incorporate a GRAT into the plan. Each option starts by funding a GRAT (assuming a May 2021 implementation with a total return of 7%). The Smiths will retain an annuity payment from the GRAT with the present value of any future remainder interest considered a gift. Use of a GRAT allows the clients to transfer significant assets while minimizing the gift tax.

Client profile

- Mr. Smith, age 68 and Mrs. Smith, age 65, both Preferred Non-Smoker
- They have three children, all married with grandchildren.

Fact finding

- Current net worth \$30M (including liquid investment and commercial real estate)
- Have previously used GRATs
- Average annual return on their investments is 7%

1 Using GRAT annuity as a gift to ILIT

- The Smiths fund a 10-year GRAT with \$4.6M
- The GRAT annuity will pay the Smiths ~\$495K annually for 10 years
 - > The Smiths will use these payments to gift the premium amount to the ILIT
- After year 10, the GRAT remainder interest of ~\$2.3M, will pay to the ILIT as beneficiary.
 - > The ILIT will use these funds to make all subsequent premium payments.
- This strategy uses **\$1,443,030** in gifting over 10 years.

2 Using a GRAT to exit premium-financing arrangement

- The Smiths enter a commercial finance arrangement to borrow premiums for 10 years:
 - > Assume the commercial loan interest rate starts at 2.5% and increases 20 bps annually
- They fund a GRAT with \$7.2M
- The GRAT annuity will pay them ~\$768K annually for 10 years
- The Smiths use the annuity payment they receive from the GRAT to make annual gifts to the ILIT to pay the commercial finance loan interest:
 - > Year-one interest payment/gift is \$3,608
- After year 10, the GRAT remainder interest of ~\$3.6M will pass to the ILIT:
 - > The ILIT uses these funds to repay the commercial finance lender \$1,443,030 and the difference (\$2,107,325) is used to make all future premium payments
- This strategy uses **\$278,072** in gifting-- this amount represents loan interest over 10 years

3 Use a GRAT to exit private split-dollar arrangement

- The Smiths enter a split dollar arrangement with the ILIT
- They fund the GRAT with \$7.12M
- The GRAT annuity will pay them ~\$756K for 10 years, which they use to loan the annual premium (\$144,303) to the ILIT.
- Additionally, the Smiths make annual gifts to the ILIT of the economic benefit cost under the split-dollar arrangement:
 - > Year-one economic benefit cost is \$2,034.
- After year 10, the GRAT remainder interest of ~\$3.5M passes to the ILIT:
 - > The ILIT repays the Smiths (\$1,443,030) for the split-dollar loan and retains the difference (\$2,048,161) to make all future premium payments.
- This strategy uses **\$54,514** in gifting — this amount represents the economic benefit costs over 10 years.

4 Use GRAT to exit a private-finance arrangement

- The Smiths make a lump-sum loan of \$1,074,641 to their ILIT using a private finance loan arrangement:
 - > Loan interest rate locked in for 9 years at 1.09%, which is the May 2021 mid-term Applicable Federal Rate (AFR).
 - > The ILIT will use the loan assets of \$1,074,641 to make annual interest payments (\$11,499) to the Smiths and pay premium of \$144,303 for nine years.
- They fund a GRAT with \$7.4M.
- The GRAT annuity will pay them ~\$869K for 9 years.
- After year 9, the GRAT remainder interest of ~\$3.14M passes to the ILIT.
 - > The ILIT will repay the Smiths (\$1,074,641) and retains the difference (\$2,069,971) to make all future premium payments.
- This strategy does not use **any** gifting.

This is a supplemental illustration. Not all benefits and values are guaranteed. The assumptions on which the non-guaranteed elements are based are subject to change by the insurer. Actual results may be more or less favorable.”

Why it works

A GRAT is a planning tool that allows clients to transfer assets to “remainder persons” (beneficiaries), such as an ILIT, and minimize the gifts that will need to be used. This popular estate planning tool can help clients significantly reduce or eliminate the gift tax cost associated with the payment of life insurance premiums, especially in the future. For a specific client, the optimal approach would depend on that client’s assets, cash flow needs and gift tolerance. During client discussions, producers can combine our Advanced Markets client-facing presentations with a one-page cost comparison to show how the use of GRATs can be incorporated into their planning strategies.

Resources



**AM Blog: GRATs--
Your specialized
but overlooked tool**

Call Advanced Markets at *888-266-7498, option 3* to speak with an Advanced Markets Consultant, or email *advancedmarkets@jhancock.com*

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