

Success Strategy

Private Survivorship Split Dollar



A PLANNING TECHNIQUE WITH LOW GIFT TAX COST

You are financially successful and may be thinking about preserving your wealth for your family. Life insurance, as an estate liquidity tool, can play an important role in maintaining your wealth. Although life insurance can be owned by an Irrevocable Life Insurance Trust (ILIT)¹ so that the proceeds are not subject to estate tax, the gifts of the premiums made to the trust may be subject to gift taxes. A private Split Dollar arrangement can help to minimize or even eliminate the gift taxes so that you can secure the liquidity you need.

WHAT IS PRIVATE SPLIT DOLLAR?

A private Split Dollar arrangement involves a “split” of the costs and benefits of a life insurance contract between you and an ILIT you create. The ILIT owns a life insurance policy on the joint lives of you and your spouse.² In these types of arrangements, you pay the annual premium since the ILIT does not have the funds to do so. Fundamentally, such a plan operates like a personal loan except that the cost of the loan to the ILIT is based on an economic benefit as opposed to loan interest.

HOW IT WORKS

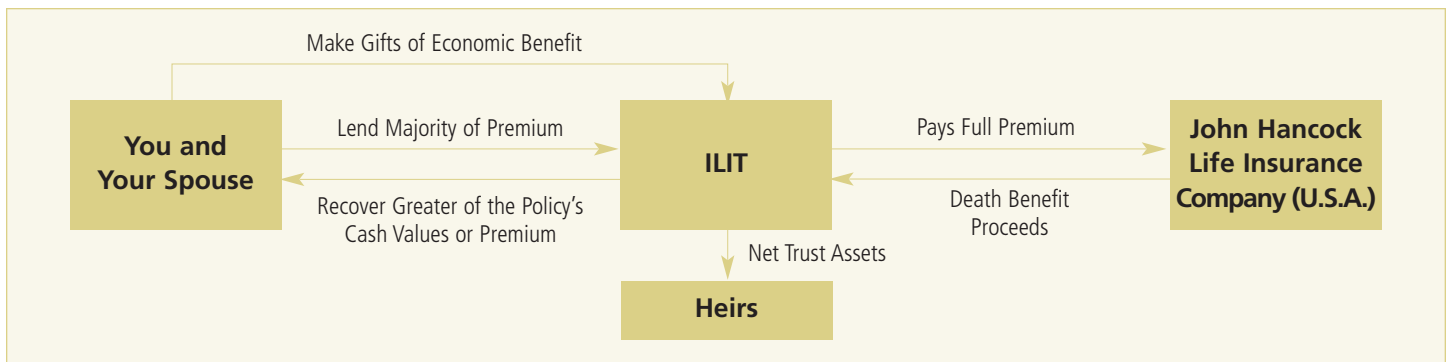
You and your spouse enter into a private Split Dollar arrangement with your ILIT. The trustee of the ILIT will then purchase a survivorship life insurance policy on the joint lives of you and your spouse. As security for the premium payments you make, you will be collaterally assigned the greater of the policy's cash value or premiums paid. At death, your estate will receive the repayment from the death proceeds. Alternatively, if the agreement is terminated during your lifetimes, the ILIT may fund the repayment from other sources available.

The value of the gift you make to the ILIT is based on the economic value of the death benefit, which initially represents only a fraction of the annual premium. The

economic value refers to the economic benefit (or term cost) of the death benefit. This economic benefit amount increases annually with your age and is derived from either a government or insurance company rate table.³ Moreover, when a survivorship policy is used, the economic benefit can be extremely low since the value of the death benefit is based on two lives. Finally, the gift of the economic benefit may be covered by your available annual gift tax exclusions, allowing you to avoid or reduce gift taxes significantly. An annual gift tax exclusion is the amount of annual gifts that each individual can make to each of an unlimited number of people without federal gift tax. In 2006, this amount is \$12,000.⁴

ANNUAL GIFT TAX COST WITH AND WITHOUT PRIVATE SURVIVORSHIP SPLIT DOLLAR		
YEAR	VALUE OF GIFT WITHOUT SPLIT DOLLAR	VALUE OF GIFT WITH SPLIT DOLLAR (ECONOMIC BENEFIT)
1	\$64,262	\$186
5	\$64,262	\$395
10	\$64,262	\$1,279
15	\$64,262	\$3,147
20	\$64,262	\$7,496

This example assumes the use of a \$5,000,000 John Hancock (U.S.A.) Survivorship UL-G policy with a guaranteed annual premium of \$64,262 on a male (59) and female (59), both Preferred Non Smokers. The data shown is taken from an illustration. It assumes an interest crediting rate of 5.25%. Guarantees are subject to the claims-paying ability of John Hancock Life Insurance Company and assumes no policy loans or withdrawals are taken from the policy. The economic benefit is based on the Table 2001 rate table.



BENEFITS

- *Estate liquidity.* You can secure life insurance protection while minimizing or eliminating gift taxes.
- *Planning flexibility.* You can lock in your insurability now.⁵ If the estate tax is repealed in 2010, you have the flexibility to terminate the arrangement and cancel or maintain the policy depending on your needs.
- *Reduction in gift tax value.* The economic benefit rates for survivorship policies are extremely low, reducing the plan's gift tax cost.
- *Cost-effective alternative to financing premiums.* The gift tax cost of the plan can be significantly lower than the loan interest cost in a premium loan arrangement.
- *Leveraged gifts.* You can leverage your annual gift tax exclusion gifts significantly with life insurance.

CONSIDERATIONS

- *Cash flow.* Cash flow is required when using a private Split Dollar plan.
- *Increasing economic benefit.* The economic benefit costs will increase over time, increasing the plan's gift value.
- *Estate taxation of repayment.* The repayment of the collateral assignment amount is included in your taxable estate.
- *Lifetime termination of arrangement.* It is important to consider the funding sources available for a lifetime termination of the plan.
- *Final Split Dollar Regulations.* The 2003 Final Split Dollar Regulations dictate the structure and taxation of Split Dollar plans.

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1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. Final Regulations issued by the Treasury and IRS on September 11, 2003 for the first time provide a definition of Split Dollar arrangements. The definition is designed to "catch" all the myriad variations of Split Dollar and apply the new taxation rules to them.
3. These tables are referred to as the Government 2001 rate table or the insurer's alternative term rates. Please see IRS Notice 2002-8 as well as the 2003 Final Split Dollar Regulations. For a summary of the rules, please see the Comprehensive Split Dollar Client Guide.
4. See IRC §2503(b). The annual exclusion is indexed annually for inflation and subject to specific rules.
5. You must satisfy all of John Hancock's medical and financial underwriting requirements.



Insurance products are issued by John Hancock Life Insurance Company (U.S.A.), 197 Clarendon Street, Boston, MA 02116.

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