Introduction to Private Placement Variable Annuity (PPVA) and Private Placement Variable Universal Life (PPVUL) Investment Accounts

Houston Business and Estate Planning Council

November 17, 2016 • Houston, TX

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THINKING OUTSIDE THE BOX

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PPVA Investment Accounts are long-term investments. The value of a PPVA Investment Account will fluctuate and, when redeemed, may be worth more or less than the original deposit. Withdrawals or other distributions, including death benefit payments, will be subject to ordinary income tax. If withdrawals or other distributions are taken prior to age 59½, a 10% excise tax may apply to the gain element. South Dakota charges a premium tax for PPVA Investment Account deposits. California, Maine, Nevada, Puerto Rico, West Virginia, and Wyoming charge a tax upon annuitization of a PPVA Investment Account. A PPVA Investment Account may include additional fees such as placement fees and performance fees. None of the illustrations contained herein assume these fees. The returns would be lower if these fees become applicable.

A PPVUL Investment Account combines the protection and tax advantages of life insurance with the investment potential of a comprehensive selection of variable investment options. The insurance component provides death benefit coverage and the variable investment component provides you the flexibility to potentially increase the policy's surrender and loan value.

The tax and legal references attached herein are designed to provide accurate and authoritative information with regard to the subject matter covered and will be provided with the understanding that the presenter is not engaged in rendering tax, legal, or actuarial services. If tax, legal, or actuarial advice is required, you should consult your accountant, attorney, or actuary. The presenter does not replace those advisors. This analysis does not include any fees charged by professional advisors engaged by the client for tax and/or legal advice.

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Investors should consider the investment objectives and horizons, income tax brackets, risks, charges, and expenses of any variable product carefully before investing. This and other important information about the investment company is contained in each fund's offering memorandum, which can be obtained by calling 512.735.7254. Please read it carefully before you invest.

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I. Increase in Tax Rates for Investment Income

	2012	Present	% Increase
Federal Rate on Ordinary Income:	35.00%	44.60% [1]	27.43%
Federal Rate on Capital Gains:	15.00%	25.00% [1]	66.67%
Federal Rate on Dividends:	15.00%	25.00% [1]	66.67%

1. Includes 3.80% to account for Medicare Contribution Tax and 1.20% to account for Limitation on Itemized Deductions (Pease Amendment).

I. Increase in Tax Rates for Investment Income (continued)

EXAMPLE:

A High Net Worth Houston, Texas resident is invested in a hedge fund of funds

(75% Short Term Capital Gains / Ordinary Income; 25% Long Term Capital Gains)

Return After Fund Management Fees:	**7.00%**
Federal Tax Rate at 39.7% [(43.4% * 75%) + (23.8% * 25%)]:	**-2.70%**
State and Local Tax at 0.0% Combined:	**0.00%**
Deduction for State and Local Tax:	**0.00%**
Net After-Tax Return:	**4.30%**

1. Assumes that investment management fees are tax-deductible, which may not be the case if the client has a high Adjusted Gross Income (AGI).
2. Tax rates assume no additional tax legislation is enacted.
3. Federal tax rate excludes 1.20% Limitation on Itemized Deductions (Pease Amendment).

I. Increase in Tax Rates for Investment Income (continued)

EXAMPLE:

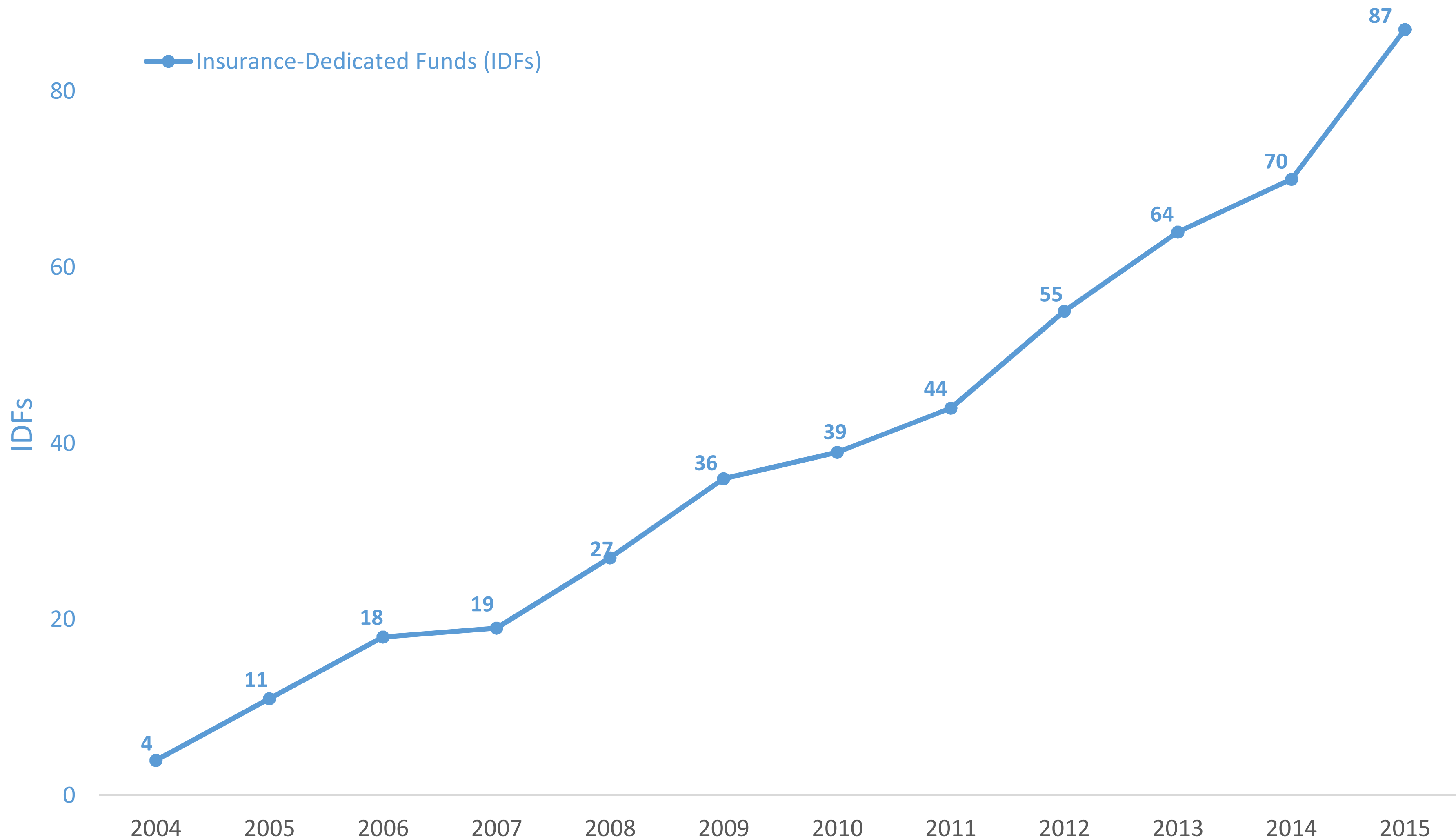
A High Net Worth California resident is invested in a hedge fund of funds

(75% Short Term Capital Gains / Ordinary Income; 25% Long Term Capital Gains)

Return After Fund Management Fees:	**7.00%**
Federal Tax Rate at 39.7% [(44.6% * 75%) + (25.0% * 25%)]:	**-2.78%**
State and Local Tax at 13.3% Combined:	**-0.93%**
Deduction for State and Local Tax:	**0.37%**
Net After-Tax Return:	**3.66%**

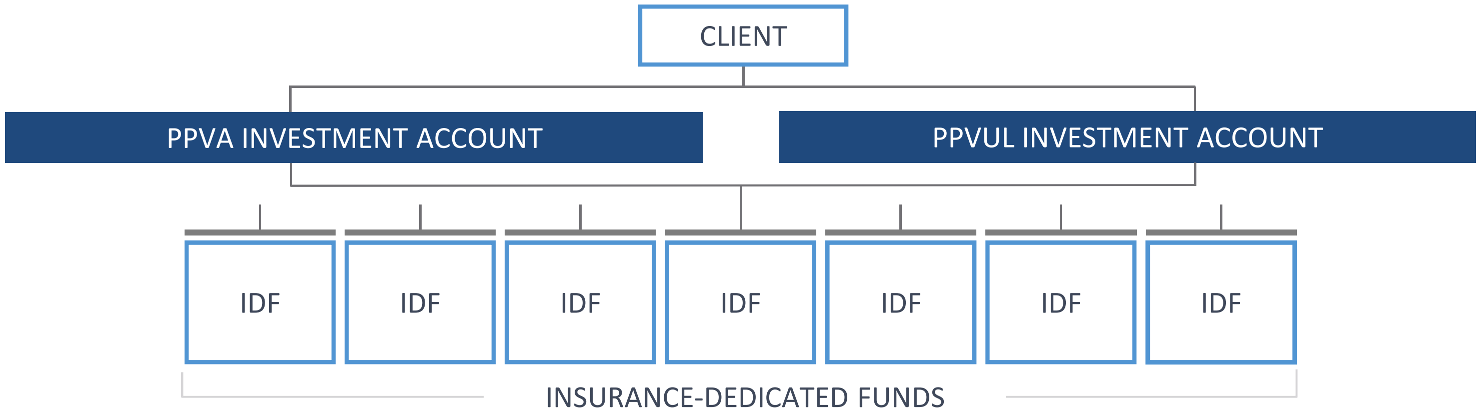
1. Assumes that investment management fees are tax-deductible, which may not be the case if the client has a high Adjusted Gross Income (AGI).
2. Tax Rates assume no additional tax legislation is enacted.

II. Growth in IDFs Since Inception



Data provided by SALI Fund Services.

III. PPVA and PPVUL Investment Accounts: An Overview



<u>PPVA</u>

- <u>Investment account</u> administered by an insurance company
- Conforms to the statutory requirements to be treated as an annuity for tax purposes
- Key attribute: <u>deferral</u> from current period income tax
- Lifetime distributions are taxed as ordinary income to the extent of the gain
- Deferred taxes are eliminated if bequeathed to charity

<u>When to Use</u>

- For allocations to highly tax-inefficient funds
- When simplicity is a key driver of decision making
- **Largest transactions: assets retained on balance sheet that are likely to be bequeathed to charity**
- Minimum deposit: $500k

<u>PPVUL</u>

- <u>Investment account</u> administered by an insurance company
- Conforms to the statutory requirements to be treated as life insurance for tax purposes
- Key attribute: income tax <u>elimination</u>
- Lifetime distributions are tax-free (withdrawals to basis and policy loans)
- Deferred taxes are eliminated at death of the insured

<u>When to Use</u>

- For allocations to highly tax-efficient and tax-inefficient funds
- When complexity can be tolerated for material incremental value-creation
- **Largest transactions: trust-owned assets**
- Minimum deposit: $5MM

IV. PPVA and PPVUL Investment Accounts: Key Applications

- Investment Portfolio Assets: Tax-inefficient investments
- Charitable Legacy planning: Retain ownership, defer income tax, deliver 100% to charity
- Grantor Trusts: Turning off the Grantor's income tax liability, insuring G2 for longer durations

V. Tax-Compliant IDF: Three Basic Elements

STRUCTURE

The IDF must be structured as a separate legal entity attached to, but distinct from, the life insurance company's segregated asset account.

DIVERSIFICATION

The IDF must be broadly diversified with:
no more than 55% of its assets allocated to any 1 investment,
no more than 70% of its assets allocated to any 2 investments,
no more than 80% of its assets allocated to any 3 investments, and
no more than 90% of its assets allocated to any 4 investments.

INVESTOR CONTROL

No Private Placement Variable Universal Life (PPVUL) or Private Placement Variable Annuity (PPVA) Investment Account owner can directly or indirectly influence the IDF manager with respect to the selection of funds or securities to fulfill the IDF's investment mandate.

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