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Charitable Planning With Private Placement Variable Annuities

Incorporate charity into a plan while maintaining the flexibility to change with the times.

By **Matthew Phillips** and **Jeri Turley**

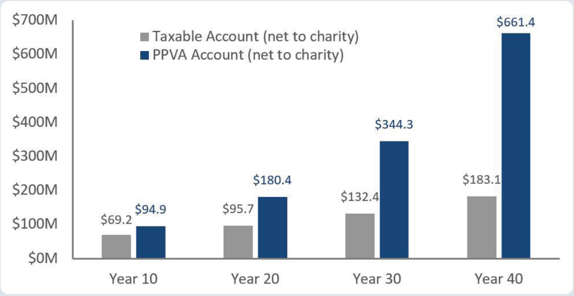
Many people use their last will and testament to make bequests to charity. However, there may be a better way to optimize the assets while maintaining control of them.

Let's look at the story of a generous 65-year-old widow. She had a sizable investment portfolio that would be left to charity; however, she wasn't comfortable giving her wealth away until she passed. She considered outright gifts and contributions to a donor-advised fund (DAF) or charitable remainder trust (CRT), but ultimately decided that she was not ready to part with control of the assets for fear she may need them someday and would regret the irrevocable donation.

The first alternative was to simply retain the assets and give them away through her will at her death. The downside of this strategy was that she would incur tax generated by investment gains in the portfolio. It was bothersome to her that she would pay income tax on money that was ultimately going to be left to the foundation.

An advisor suggested another solution—a Private Placement Variable Annuity (PPVA)—which accomplished all her objectives. A PPVA is a uniquely flexible financial tool that ultra-affluent, U.S. taxpaying families are increasingly integrating into their charitable planning strategy because it can eliminate income taxes generated by investment gains, while still allowing the

Future Value of a $50 Million Investment Earmarked for Charity Using a PPVA Account Versus a Taxable Account



Key Assumptions: 7.00% Net Return; 75% STCG / Ordinary Income; 25% LTCG

1. Private Placement Variable Annuity (PPVA) Account assets are held in Separate Accounts that are not subject to credit risk with respect to the life insurance company.

2. Assumes a net level annual rate of return of 7.00% after a 1.50% investment management fee on a $50 million investment in a PPVA Account and a Taxable Account, 75% of realized gains are taxed at the Short Term Capital Gains (STCG) / Ordinary Income rate, 25% of realized gains are taxed at the Long Term Capital Gains (LTCG) rate, and no withdrawals are made before age 59½. There is a 10% excise tax on gains if withdrawals are made from a PPVA Account before age 59½.

3. Assumes that investment management fees are not tax-deductible in the Taxable Account. The PPVA Account enables all investment management fees and expenses to become effectively tax-deductible.

4. The example assumes a STCG / Ordinary Income tax rate of 47.80% and LTCG tax rate of 30.80% based on Connecticut residency. Assumes the tax rates shown will be applicable for all years.

5. The analysis above does not include any fees charged by professional advisors engaged by the client for tax and/or legal advice.

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Winged Keel Group is widely recognized as one of the leading experts in the structuring and administration of Private Placement Life Insurance and Annuities, with offices across the country. For more information, please visit www.wingedkeel.com.

owner to maintain control of the assets during their lifetime.

The investments inside a PPVA account grow income-tax-deferred, and investment options include both alternative and traditional asset classes, such as direct lending, opportunistic credit, hedge funds and mutual funds. The owner maintains complete control over the PPVA during their lifetime, including the right to take distributions and change the beneficiary.

If the beneficiary is a private foundation or public charity, it receives the proceeds of the PPVA income-tax-free. The beneficiary (charity) can be structured so that the charity receives the assets either at the death of the initial owner or after the PPVA proceeds have been "rolled over" to a surviving spouse. The latter results in additional years of tax-free compounding, often resulting in significantly larger balances going to the charity than if the payout was made at the death of the first spouse. If the values of the PPVA are accessed by the owner during their lifetime, the gain is taxed as ordinary income.

Since the PPVA owner maintains control and access to the value in the PPVA while they are alive, there is no income-tax deduction on the cash contribution used to fund the PPVA. If a family is willing to part with control of the assets and make the donation to charity during their lifetime, they might instead utilize a financial tool that provides an immediate income tax deduction, such as a CRT or a DAF. Families that use PPVA today generally do so as part of a two-pronged approach: (1) an outright gift, CRT and/or DAF for donations during their lifetime to benefit from the income tax deduction and future income-tax-free appreciation; and (2) a PPVA for charitable bequests at death to benefit from tax-deferred growth of the account value while maintaining control of the assets.

A PPVA differs from a retail variable annuity in that the cost structure is generally lower. A retail variable annuity can have expensive riders, driving the cost upwards of 250 basis points per year and containing large surrender charges for early termination. A PPVA can be structured with a tiered fee schedule and a price cap of 55 basis points for deposits of $5 million, with a lower fee for larger premium deposits. There are no surrender charges or additional PPVA fees.

PPVAs are gaining traction among ultra-affluent families who are incorporating a charity into their estate plan and want the flexibility to change their minds in the future if financial markets don't cooperate or their desires change. The aforementioned example, in which the widow was able to leave more than $80 million more to charity while retaining control of her assets at her death at age 85, illustrates why a PPVA can be more attractive than making a charitable bequest through a last will and testament.

Key Features of a PPVA

- Defer income tax on investment gains
- Eliminate income tax by leaving assets to charity
- Maintain control of assets through owner's lifetime
- Access alternative and traditional asset class investments
- Leave a significantly larger legacy for charity of choice

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