



Winged Keel Group Insights

Case Study: Optimizing Foreign Non-Grantor Trust Assets with Private Placement Life Insurance (PPLI)

Winged Keel Group Insights is a publication designed to educate and build awareness around life insurance topics and solutions that may address certain needs of your clients and their multidisciplinary goals.

Utilizing PPLI to Mitigate the Throwback Tax and Interest Penalties of a Foreign Non-Grantor Trust

Client Profile: Multigenerational ultra-high-net-worth family with assets in an existing foreign (non-U.S.) trust.

Background: A European family relocated to the Caribbean and established a series of non-U.S. trusts. Successive generations from the family moved to the U.S. and their children are U.S. citizens and residents.

Following the passing of the last non-U.S. citizen family member, the trust will be determined to be a foreign non-grantor trust, with U.S. beneficiaries incurring a throwback tax and interest penalty on any undistributed net income (UNI).

One potential mitigation strategy is to distribute all of the distributable net income (DNI) annually, but this would deplete the trust assets for successive generations. On the other hand, deferring distributions could result in confiscatory taxes (the throwback tax) and interest equaling as much as 100% of the trust distribution.

Action Plan: In an effort to mitigate UNI accumulations and associated taxes on future trust distributions, the trustees considered a variety of alternatives. Exercising the Default Method for future accumulation distributions would negate the income tax penalty, but it would result in ordinary income tax on trust distributions, require a mandatory distribution schedule, and ultimately force a complete payout of all trust assets to the beneficiaries, thus exposing the proceeds to U.S. transfer taxes and creditors.

In conjunction with counsel, their advisor recommended an alternative option: repositioning the existing liquid trust assets into Private

Placement Life Insurance (PPLI) to effectively eliminate trust fiduciary accounting income, avoiding UNI accumulations and:

- Providing tax-free account value accumulation;
- Creating the ability to reallocate among available policy investment options without creating DNI;
- Allowing the beneficiaries to access money tax-free during the insured's lifetime through tax-free withdrawals of basis and tax-free loans; and
- Ensuring policy beneficiaries receive insurance benefit proceeds tax-free without creating DNI.

Counsel identified the preferred trust, which was holding liquid investments totaling \$50M. These trust assets were repositioned inside of a PPLI policy via two deposits, both completed prior to the passing of the senior non-U.S. family member and before the trust was deemed a foreign non-grantor trust (FNGT).

Editorial Note: In many cases, the trust may already be determined to be a FNGT with UNI accumulations and tax penalties. In these situations, there are strategies for incorporating PPLI to mitigate ongoing UNI accumulations and to creatively structure future distributions to avoid the interest penalty. Additional planning may also be considered to further enhance the benefits to U.S. trust beneficiaries.

Result: The trust acquired a PPLI Account and invested \$50M of assets, sequencing the deposits over a two-year period. The trustee and investment advisor worked together to create a

custom-mandate for the allocated deposits, complementing the remaining illiquid investment portfolio held in the other family trusts. Over the next 40 years, the trust is illustrated to save \$724M in throwback taxes and interest penalties, which would have been applied against any trust distributions. In addition, the trust receives the insurance benefit tax-free, which can be redeployed into future policies that provide ongoing deferral opportunities. Trust assets continue to be retained in the non-U.S. trust and can be accessed tax-free during the insured's lifetime for discretionary trust distributions.

PPLI Overview: PPLI Accounts have unique tax characteristics that allow invested assets to grow on a tax-deferred basis and be paid out income tax-free. As the policyowners, the trustees have complete discretion to allocate and reallocate among all the investment options made available by the insurance company. The menu of investment options offered has expanded dramatically in recent years, and for clients making sizable investments in PPLI, it may be

possible to create a customized investment offering tailored to meet their objectives.

Additionally, the PPLI Account owner can access 80% – 85% of the account value on a tax-free basis during the lifetime of the insured through a combination of withdrawals of cost basis (FIFO taxation) and low-cost policy loans. The insurance benefits are received income and capital gains tax-free, enhancing the family's ability to efficiently leverage the non-U.S. trust assets to transfer wealth for multiple generations within their existing offshore trust structures.

Conclusion: PPLI continues to be an attractive option for UHNW families as they address planning challenges and goals. It is critical to work with experienced advisors who understand the complexities of PPLI and can provide the appropriate guidance and insight. To learn more, reach out to your Winged Keel Group relationship manager. For more information on Winged Keel, please visit our website at wingedkeel.com.

Hypothetical PPLI Account versus Hypothetical Taxable Account in FNGT

Comparative Economic Results: \$50 Million Investment* See Notes

Multiple U.S. Family Member Insureds; Preferred Non-Smoker Life Insurance Risk

7.00% Net Annual Rate of Return; 100% LTCG

Year	Annual Deposit	U.S. Domestic PPLI Account *		Foreign Non-Grantor Trust (FNGT) Taxable Account **			
		End of Year Account Value	End of Year Insurance Benefit	End of Year Account Value	Estimated Throwback Tax & Penalty	As % of Account Value	Net Distribution
1	25,000,000	25,919,990	475,919,990	26,750,000	773,460	2.89%	25,976,540
2	25,000,000	53,545,134	503,545,134	55,372,500	2,437,206	4.40%	52,935,294
3	0	56,925,709	450,000,000	59,248,575	4,347,389	7.34%	54,901,186
4	0	60,527,806	450,000,000	63,395,975	6,528,739	10.30%	56,867,236
5	0	64,360,997	450,000,000	67,833,694	9,007,970	13.28%	58,825,723
10	0	87,931,772	217,615,294	95,140,264	26,958,035	28.34%	68,182,229
20	0	164,911,718	323,157,294	187,155,300	107,631,442	57.51%	79,523,858
30	0	314,628,928	435,006,481	368,162,802	304,283,425	82.65%	63,879,378
40	0	600,224,497	699,420,897	724,231,956	724,231,956	100.00%	0
50	0	1,145,250,873	1,202,513,416	1,424,673,876	1,424,673,876	100.00%	0

*Assumed rate of return net of 1.50% Investment Management Fees: 7.00%

**Assumes the current 8.00% IRS Section 6621 underpayment rate is applicable in all years

Notes:

1. These results are for illustrative/informational purposes only and may not reflect the typical purchaser's (client's) experience. These results are not intended to represent or guarantee that any client will achieve the same or similar results.
2. Assumes the net level annual rates of return shown above after a 1.50% investment management fee and before insurance-related charges on a \$50 million investment in a PPLI Account and a Taxable Account, 0% of realized gains are taxed at the Short Term Capital Gains (STCG)/Ordinary Income rate, and 100% of realized gains are taxed at the Long Term Capital Gains (LTCG) rate.
3. Assumes that investment management fees are not tax-deductible in the Taxable Account.
4. Assumes a STCG/Ordinary Income tax rate of 47.80% and LTCG tax rate of 30.80%. Assumes the tax rates shown will be applicable for all years.
5. Assumes Insureds, males age 32, female age 28, and male age 27 will be classified as a Preferred non-smoker life insurance risks. The life expectancy of a male age 32 classified as a Preferred non-smoker life insurance risk is 58 years, based on Society of Actuaries' 2008 VBT Select mortality table. The life expectancy of a female age 28 classified as a Preferred non-smoker life insurance risk is 64 years, based on Society of Actuaries' 2008 VBT Select mortality table. The life expectancy of a male age 27 classified as a Preferred non-smoker life insurance risk is 63 years, based on Society of Actuaries' 2008 VBT Select mortality table.
6. Assumes the PPLI policy is issued in South Dakota and qualifies as a non-Modified Endowment Contract (non-MEC). Under current tax law, if the policy lapses or is surrendered, all investment gains in excess of the policyowner's cost basis are taxed to the policyowner as Ordinary Income in the year the policy lapses or is surrendered.
7. The analysis above does not include any fees charged by professional advisors engaged by the client for tax and/or legal advice.

DISCLOSURES

A Private Placement Life Insurance (PPLI) Account is an unregistered securities product and is not subject to the same regulatory requirements as registered products. As such, a PPLI Account should only be presented to accredited investors or qualified purchasers as described by the Securities Act of 1933.

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A PPLI 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 PPLI Account'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 are provided with the understanding that Winged Keel Group 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. Winged Keel Group 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.

The tax rates and tax treatment of earnings may impact comparative results. Lower maximum tax rates on capital gains and dividends would make the investment return for the Taxable Account more favorable, thereby reducing the difference in performance between the accounts shown. Investments in securities involve risks, including the possible loss of principal. When redeemed, units may be worth more or less than their original value.

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The financial illustrations and other statements within this report, as well as comments made by any individuals, are not guaranteed and do not constitute a contract. Any contract entered into is between the PPLI Account owner and the insurance company, through its PPLI policy. You should read the PPLI Account contract and offering documents thoroughly.

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 212.527.8000. Please read it carefully before you invest.

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