

Qualified Account
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Replacement Trust
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Presented By:

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Qualified Account Replacement Trust

The Scenario:

Many financial planners encounter clients who have accumulated millions of dollars in qualified accounts for which they do not foresee a need. If younger than 59 ½, they believe that they cannot use the qualified account assets for current capital transfer strategies without incurring significant penalties or limitations.

As these clients approach retirement with other, more income tax-efficient assets available to them, they often times avoid pulling any money out of their qualified accounts. The ordinary income tax recognition any disbursements from IRA's, 401(k)'s, etc. will produce is very unattractive to these already wealthy individuals.

Of course, with required minimum distributions beginning at age 70 ½, these people eventually must withdraw a federally defined minimum amount each year. These required minimum distributions, or "RMDs," force clients to pay ordinary income taxes on 100% of these withdrawals, regardless of whether they actually need the income.

Finally, even if these frustrated clients manage to limit their withdrawals exclusively to RMDs and keep their qualified accounts invested in growth-oriented portfolios, at death they face crippling transfer taxes if they bequeath these funds to their heirs. When combined, estate taxes and income in respect of a decedent taxes, or "IRD" taxes, can reach as high as 75% of the qualified account balance! "Stretch" IRA techniques may spread the recognition of income taxes over the life of the plan owner and the owner's designated beneficiary, but they do nothing to avoid estate taxes.

A challenge for planners is to come up with techniques to transfer these unneeded (and sometimes unwanted) qualified accounts out of their clients' taxable estates and into the hands of the clients' heirs, all the while avoiding income taxes and estate taxes on these accounts as much as possible. One potential answer is what we call the "Qualified Account Replacement Trust," or "QART."

The Idea:

The QART can vary in complexity, but in its simplest form, it uses tax deferred, Individual Retirement Accounts to leverage an asset transfer of non-qualified assets to a client's heirs. It can defer recognition of income taxes on qualified account transfers. In fact, with the use of a variety of integrated techniques, it significantly reduces income taxes on certain transfers. The heirs, who can be either children or grandchildren, end up with cash at a 100% income tax basis, no strings attached. To avoid taxes on the transfer of the qualified account, we recommend that the client designate a charity as beneficiary. Of course, the qualified account could pass to the heirs as well, but this transfer would not avoid taxes.

How It Works:

If the client foresees an income need for at least a portion of the IRA during retirement, an existing IRA can be divided into two separate IRAs. One new IRA can retain the same investment mix as the original, single IRA, while the second, newly formed IRA will invest exclusively in a newly formed Limited Liability Company (LLC). The LLC will be formed for the purpose of managing investments and it will issue all initial shares to this second IRA. If the client does not foresee any need for the qualified account, the existing IRA may directly invest in the newly formed LLC without the need for a second IRA.

The LLC will invest a portion of its funds each year into a variable life insurance contract through a private split-dollar agreement with an Irrevocable Trust (referred to henceforth as the QART) established by the client. These investments in the split-dollar plan will not be treated as income and therefore the client will not owe income taxes on these amounts. During the split-dollar agreement, the QART will pay the equivalent term cost of the coverage annually and the LLC will pay the remaining premium as an investment in the cash value portion of the life insurance policy. The LLC will at all times own the right to the policy's cash value.

The split-dollar agreement will be scheduled to "crawl out." Also, the variable life insurance policy should be structured to be "self funding" by the expected beginning date of this "crawl out." Finally, before the "crawl out" begins, the LLC should retain only its interest in the split-dollar agreement and divest all other holdings.

The ideal time to begin this "crawl out" should coincide with the client's first Required Minimum Distribution (RMD). Thus, beginning at the client's age of 70 ½, LLC shares held by the IRA should be withdrawn, in kind, along with enough liquid securities to cover the income tax on the total withdrawal. For example, at a tax rate of 39.6% and an RMD of \$165,563, a client could withdraw \$100,000 worth of LLC shares and another \$65,563 of other liquid securities. The liquid securities would be sold for cash to pay the income tax owed on the \$165,563 RMD. This income tax would amount to \$65,563. In this above scenario, the client is left with \$100,000 of LLC units, owned outright, with a 100% income tax basis. If tax efficient, the client may gift these LLC shares (which are no longer held by the IRA) each year to the QART using a combination of annual gift exclusions, applicable exclusion amounts, and generation skip tax credits. Any transfers exceeding these exclusions would trigger transfer taxes. If the client does not wish to use these exclusions, the QART may purchase the withdrawn LLC units through various methods including:

1. Cash payment
2. Like kind transfer of assets (deemed a sale by the IRS for income tax purposes)
3. Cash from the policy's invested assets
4. Any other means of capital repayment

This pattern of annual withdrawals of Required Minimum Distributions, income tax payments, and the gift or sale of the withdrawn LLC shares to the QART should continue until the QART owns the entire LLC. Once the QART owns all LLC shares, the split-dollar agreement can be

“torn up.” Of course, if an earlier “crawl out” date is desired, the withdrawals may begin before the client reaches 70 ½. Keep in mind that the client should be over 59 ½ before distributions begin or early withdrawal penalties may apply.

As long as an IRA exists, the client must withdraw Required Minimum Distributions (RMDs) after age 70 ½. The QART does not eliminate this issue. In fact, due to RMDs, with the exception of any differential in overall return on investment, this strategy will result in the payment of approximately the same amount of income tax that would have been paid if the strategy had not been pursued. Also, if the IRA passes to the heirs instead of charity, transfer taxes on this qualified account may be approximately the same, with or without the QART.

An interesting strategy to use with the “crawl out” that would maximize the total transfer of assets to the heirs would involve repayment by the QART. If the QART can repay the entire obligation to the LLC without invading policy values, the QART will maintain the maximum death benefit possible. For the QART to accomplish a self-funded “crawl out,” corresponding leveraged transfer techniques should be developed to coincide with the timing of the split-dollar “crawl out.” The QART should be designated as the beneficiary of these corresponding transfers. Excellent leveraged transfer strategies include:

1. Intentionally Defective Irrevocable Trust funded with LLC or Family Limited Partnership (FLP) non-voting units
2. Grantor Retained Annuity Trust funded with LLC or Family Limited Partnership (FLP) non-voting units
3. Charitable Lead Annuity Trust funded with LLC or Family Limited Partnership (FLP) non-voting units (either Grantor or Non-Grantor status)
4. Annual gifting programs using the \$10,000 annual gift exclusions funded with LLC or Family Limited Partnership (FLP) non-voting units
5. A combination of the four techniques above

The End Result:

If the QART refunds the split-dollar obligation with funds received from a corresponding transfer strategy, the client has effectively taken an unused asset bound with strict limitations, potentially high income tax ramifications, and potentially disastrous transfer tax exposure, and leveraged it to the heirs with minimal tax impact! Remember, regarding RMDs, this strategy does not really diminish the income tax interests of the IRS. Also, the QART does not require “proprietary” insurance products with springing cash values. Any variable life product could work.

Research for QART:

Scott J. Hamilton, Esq., Structured Financial Growth Advisors, LLC, Newtown, CT
IRS Code Sections: 408 & 4975

James H. Swanson & Josephine A. Swanson vs. Commissioner: Docket No. 21203-92
Department of Labor Opinions: 89-03 A & 2000-10 A
Private Letter Ruling 83-38141

Case Example: John & Joan Smith

The following case example illustrates the hypothetical cash flows of John & Joan Smith. John is a 55 year old, healthy, non-smoking male with an IRA worth \$2,000,000. He and his 53 year old, healthy, non-smoking wife own liquid marketable securities worth \$10,000,000, in a total taxable estate worth \$15,000,000 (including the IRA). Their joint life expectancy is 32 years. The QART acquires a variable joint universal life insurance product and enters a split-dollar agreement with the LLC 1.

To coincide with the split-dollar agreement so that the QART will have funds available to purchase the LLC 1 shares once RMDs begin, the QART is established as an Intentionally Defective Irrevocable Trust (IDIT). Then, the Smiths create a second LLC and fund it with \$3,000,000 of marketable securities. The LLC 2 B shares recognize a valuation adjustment of 30% due to their lack of marketability, etc. Ten percent of the LLC 2 B shares are gifted to the QART and the remaining 90% are sold to the QART through an installment sale. In ten years, the QART will have completed the installment sale and have unencumbered ownership of the LLC 2 B shares. In fifteen years, John will reach 70 ½ and must begin his Required Minimum Distributions. With permission from the A shareholders (the Smiths), the QART will liquidate enough shares to purchase the withdrawn LLC 1 shares each year and pay any resulting capital gains taxes from this liquidation.

Over a period of years, all LLC 1 shares will have been withdrawn from the IRA and the QART will have purchased them. Therefore, the QART will then own the “self funding” variable insurance policy outright, as well as any remaining investments held by the LLC 2 B shares. The IRA will no longer own any LLC shares, instead maintaining a typical marketable security portfolio.

In this example, the QART returns the split-dollar contributions by purchasing the LLC 1 shares. The QART experienced an advantage above Status Quo by entering into the installment sale of LLC 2 B shares. This advantage is a combination of the 30% discount applied to the B shares along with the initial gift to the QART representing 10% of the LLC 2 B shares. This advantage equates to \$1,098,900 today. This amount of marketable securities, if also transferred to the heirs in the Status Quo scenario utilizing the same amount of applicable exclusions used to gift shares to the QART, would equal about \$587,000 net of 55% estate or gift taxes. If these marketable securities transferred to the QART via the installment sale where assumed to earn 10% annually, this advantage is compounded at 10% annually to show the impact in future years. This advantage is subtracted from the QART benefits to show a “net benefit” to the heirs in more of an “apples to apples” comparison.

In summary, the Smiths were able to use the IRA and a portion of their marketable securities to leverage millions to their children and grandchildren transfer tax-free.

QART: Illustration

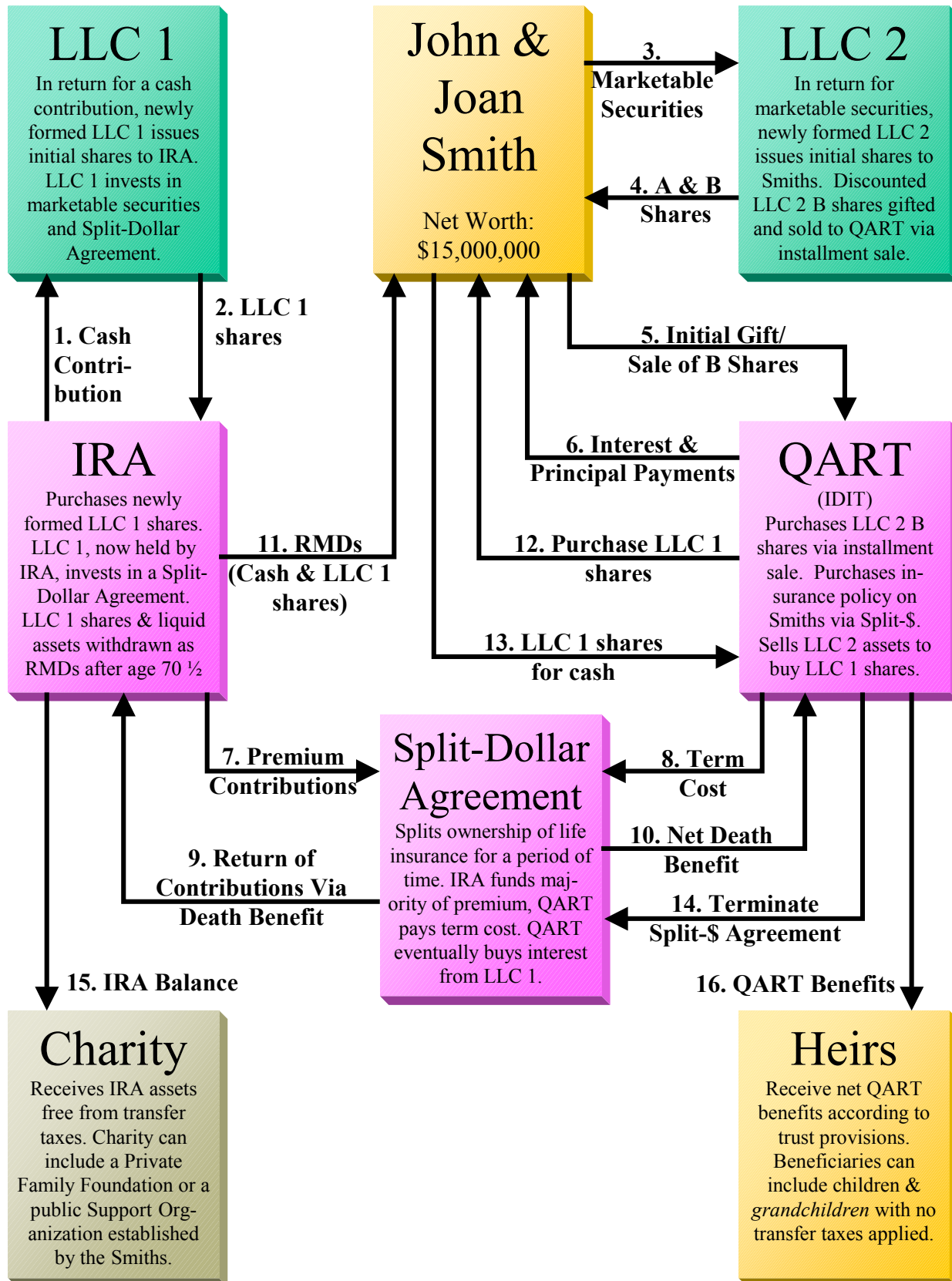


Illustration Description:

Step 1: An existing IRA will invest exclusively in a newly formed Limited Liability Company One (LLC 1). The LLC 1 will be formed for the purpose of managing investments.

Step 2: The LLC 1 will issue all initial shares to the IRA.

Step 3: For the QART to accomplish a self-funded “crawl out,” a corresponding leveraged transfer technique should be developed to coincide with the timing of the split-dollar “crawl out.” Therefore, a second Limited Liability Company (LLC 2) is created and funded with a portion of the Smith’s marketable securities.

Step 4: The LLC 2 will issue all initial shares to the Smiths. These shares will include voting A shares representing 1% of the LLC 2 value, and non-voting B shares making up 99% of the LLC 2 value.

Step 5: Choosing an Intentionally Defective Irrevocable Trust structure for the QART, the Smiths gift initial “seed” money in the form of discounted LLC 2 B shares (Non-voting shares). The QART then purchases the remaining B shares through an installment sale.

Step 6: The terms of the installment sale to the QART include annual interest payments as well as discretionary principal repayments. The QART should repay principal at a rate so that the sale will be complete by the beginning of the split-dollar “crawl out.” The QART will remain “defective” for income tax purposes until the installment sale is complete. Therefore, the Smiths will pay the income taxes realized by the QART during this time.

Step 7: The LLC 1, held by the IRA, will invest a portion of its funds each year into a variable life insurance contract through a private split-dollar agreement with the QART. These investments in the split-dollar plan will not be treated as income and therefore the Smiths will not owe income taxes on these amounts. The LLC 1, through its investment in the split-dollar agreement, will contribute the majority of the premium each year. The LLC will at all times own the right to the cash value of the contract.

Step 8: The QART will pay the equivalent term cost of the coverage annually. Consequently, it will own the life insurance policy’s death benefits, less any obligation to the LLC 1 for its premium contributions. The split-dollar agreement will be scheduled to “crawl out,” (i.e. return of cash values) ideally within 10 to 15 years. Also, the variable life insurance policy should be structured to be “self funding” by the expected “crawl out” date. At the “crawl out,” the QART, with the permission of the LLC 2 A shareholders (the Smiths), will sell securities held in the LLC 2, and use the cash from the sale to purchase LLC 1 shares. Also, any resulting capital gains taxes from the security liquidation will be paid by the QART.

Step 9: Whether the Smiths both survive the term of the split-dollar agreement, or if they both die before the agreement has ended, the QART will repay the LLC 1 for its cash value interest in the policy. If the Smiths both die while the split-dollar agreement is still active and the “crawl

out” has not begun, the repayment of cash value will go entirely to the IRA. The source of this repayment, while not specified, will most probably come from the death benefits received by the QART at the surviving spouse’s death.

Step 10: At the surviving spouse’s death, the QART will receive the death benefit from the variable joint life insurance, less any obligation to the LLC 1 for its cash value interest through the split-dollar agreement.

Step 11: At John’s age 70 ½, Required Minimum Distributions (RMDs) begin. These distributions will be a combination of liquid securities (or cash) to pay income taxes and LLC 1 shares withdrawn in kind.

Step 12: After John’s RMDs begin, each year the QART will liquidate enough LLC 2 B shares to purchase the recently withdrawn LLC 1 shares from John.

Step 13: After John’s RMDs begin, each year John sells the LLC 1 shares he recently withdrew from his IRA to the QART for cash. Eventually, the QART will own all LLC 1 shares.

Step 14: Once the QART owns all LLC 1 shares, it will own the split-dollar contributions as well. With the entire contract owned by the same entity, the split-dollar agreement can be “torn up.”

Step 15: At the surviving spouse’s death, the IRA assets flow to a charity. This type of transfer escapes all transfer taxes. If the charity is some sort of Family Foundation (Private, Donor Advised Fund, or Support Organization), the assets will remain in the Smith family heirs’ control, albeit in a charitable sense.

Step 16: The QART distributes benefits to the Smith heirs (including children and *grandchildren*) free of any transfer taxes. The distributions may be structured according to John & Joan Smith’s wishes, including the use of various incentive clauses, if so desired.

STATEMENT OF NET WORTH

CURRENT VALUES

	<u>JOHN</u>	<u>JOAN</u>	<u>JOINT</u>	<u>TOTAL</u>
CASH AND EQUIVALENTS				
Savings	\$ 100,000	\$ 100,000	\$ 100,000	\$ 300,000
Total of Cash and Equivalents	100,000	100,000	100,000	300,000
MARKETABLE SECURITIES				
Stock Portfolio	5,000,000	5,000,000	-	10,000,000
Total of Taxable Marketable Securities	5,000,000	5,000,000	-	10,000,000
OTHER INVESTMENTS				
Smith Passive Investment	1,000,000	-	-	1,000,000
Total of Other Investments	1,000,000	-	-	1,000,000
QUALIFIED RETIREMENT PLANS				
IRA	2,000,000	-	-	2,000,000
Total Qualified Retirement Plans	2,000,000	-	-	2,000,000

STATEMENT OF NET WORTH

CURRENT VALUES

CONTINUED

	<u>JOHN</u>	<u>JOAN</u>	<u>JOINT</u>	<u>TOTAL</u>
INVESTMENT REAL ESTATE				
Smith Land Speculation	500,000	-	-	500,000
Total of Real Estate Holdings	500,000	-	-	500,000
PERSONAL RESIDENCES				
1234 Maple Street	-	-	500,000	500,000
Lake Home	-	200,000	-	200,000
Florida Condo	200,000	-	-	200,000
Total of Personal Residences	\$ 200,000	\$ 200,000	\$ 500,000	\$ 900,000
PERSONAL PROPERTY				
Art, Jewelry and Antiques	-	100,000	-	100,000
Boat	50,000	-	-	50,000
Automobiles	-	100,000	-	100,000
Furniture	-	50,000	-	50,000
Total personal property	50,000	250,000	-	300,000
TOTAL ASSETS	\$ 8,850,000	\$ 5,550,000	\$ 600,000	\$ 15,000,000
LIABILITIES				
Mortgage	-	-	-	-
TOTAL LIABILITIES	\$ -	\$ -	\$ -	\$ -
NET WORTH	\$ 8,850,000	\$ 5,550,000	\$ 600,000	\$ 15,000,000

LIMITED LIABILITY COMPANY ONE DETAILS

Qualified Account Replacement Trust

YEAR	2000	2001	2002	2003	2004	2009	2014	2019	2024	2032
Balance sheet										
Marketable securities	\$ 1,971,971	\$ 2,135,437	\$ 2,262,096	\$ 2,401,820	\$ 2,556,017	\$ 3,603,809	\$ 5,803,970	\$ -	\$ -	\$ -
Split-dollar investments	28,029	112,474	204,432	304,587	413,673	1,122,648	1,735,386	2,607,355	3,672,347	4,870,003
Assets in LLC	2,000,000	2,247,911	2,466,528	2,706,407	2,969,690	4,726,457	7,539,356	2,607,355	3,672,347	4,870,003
Discounted value of LLC B shares	-	-	-	-	-	-	-	-	-	-
Difference between LLC asset value and discounted LLC B share value	-	-	-	-	-	-	-	-	-	-
Income Statement										
Yield from securities	-	-	-	-	-	-	-	-	-	-
Income from securities sold	-	-	-	-	-	-	-	-	-	-
Taxable income	-	-	-	-	-	-	-	-	-	-
Distributions										
Total distribution to all shareholders	-	-	-	-	-	-	-	-	-	-
Ownership										
QART	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	40.7%	86.0%	99.6%
IRA	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	59.3%	14.0%	0.4%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

LIMITED LIABILITY COMPANY TWO DETAILS

Qualified Account Replacement Trust

YEAR	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2009</u>	<u>2014</u>	<u>2019</u>	<u>2024</u>	<u>2032</u>
Balance sheet										
Marketable securities	\$ 3,000,000	\$ 3,000,000	\$ 3,000,000	\$ 3,000,000	\$ 3,000,000	\$ 3,269,792	\$ 5,056,828	\$ 6,280,312	\$ 6,507,560	\$ 9,352,998
Assets in LLC	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,269,792	5,056,828	6,280,312	6,507,560	9,352,998
Discounted value of LLC B shares	2,100,000	2,100,000	2,100,000	2,100,000	2,100,000	2,288,854	3,539,779	4,396,219	4,555,292	6,547,099
Difference between LLC asset value and discounted LLC B share value	900,000	900,000	900,000	900,000	900,000	980,938	1,517,048	1,884,094	1,952,268	2,805,899
Income Statement										
Yield from securities	60,000	60,000	60,000	60,000	60,000	60,000	92,709	122,341	131,320	174,634
Income from securities sold	240,000	240,000	240,000	240,000	240,000	-	-	387,313	636,191	99,894
Taxable income	300,000	300,000	300,000	300,000	300,000	60,000	92,709	509,654	767,511	274,528
Distributions										
Total distribution to all shareholders	300,000	300,000	300,000	300,000	300,000	60,000	92,709	509,654	767,511	274,528
Ownership										
John and Joan	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
QART	99.0%	99.0%	99.0%	99.0%	99.0%	99.0%	99.0%	99.0%	99.0%	99.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

QUALIFIED ACCOUNT REPLACEMENT TRUST DETAILS

Qualified Account Replacement Trust

YEAR	2000	2001	2002	2003	2004	2009	2014	2019	2024	2032
QART Balance Sheet										
Gross value of LLC 2 Units	\$ 2,970,000	\$ 2,970,000	\$ 2,970,000	\$ 2,970,000	\$ 2,970,000	\$ 3,237,094	\$ 5,006,259	\$ 6,217,509	\$ 6,442,485	\$ 9,259,468
Net value of LLC 2 units	2,079,000	2,079,000	2,079,000	2,079,000	2,079,000	2,265,966	3,504,382	4,352,256	4,509,739	6,481,628
Gross Split-Dollar Death Benefit	10,072,618	10,152,109	10,239,112	10,334,313	10,438,444	11,122,648	11,122,648	11,122,648	11,122,648	11,122,648
Note payable to John and Joan	(1,871,100)	(1,494,139)	(1,289,080)	(1,072,117)	(842,638)	-	-	-	-	-
Split Dollar Owned by LLC 1	(28,029)	(112,474)	(204,432)	(304,587)	(413,673)	(1,122,648)	(1,735,386)	(2,607,355)	(3,672,347)	(4,870,003)
Value of LLC 1 units owned	-	-	-	-	-	-	-	1,060,640	3,158,018	4,849,726
Net equity	10,252,489	10,624,496	10,824,600	11,036,609	11,261,133	12,265,966	12,891,644	13,928,190	15,118,058	17,583,999
QART Cash Flow										
Yield from LLC 2 units	59,400	59,400	59,400	59,400	59,400	59,400	91,782	121,118	130,007	172,888
Assets sold for cash flow needs	237,600	237,600	237,600	237,600	237,600	-	-	383,440	629,829	98,895
Loan interest to Smiths	(112,266)	(101,278)	(89,648)	(77,345)	(64,327)	-	-	-	-	-
Loan principal to Smiths	(183,135)	(193,826)	(205,059)	(216,963)	(229,479)	-	-	-	-	-
Cash out for split-dollar plan	(1,599)	(1,896)	(2,293)	(2,692)	(3,194)	(7,362)	(6,378)	(320,308)	(531,415)	(162,109)
Taxes due after grantor status revoked	-	-	-	-	-	(22,544)	(35,367)	(123,672)	(176,470)	(87,264)
Cash flow to reinvest	-	-	-	-	-	29,494	50,037	60,578	51,951	22,410
Note to QART										
Outstanding note balance	1,871,100	1,494,139	1,289,080	1,072,117	842,638	-	-	-	-	-
Interest payment	112,266	89,648	77,345	64,327	50,558	-	-	-	-	-

PRIVATE SPLIT-DOLLAR DETAILS

Qualified Account Replacement Trust

<u>YEAR</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2009</u>	<u>2014</u>	<u>2019</u>	<u>2024</u>	<u>2032</u>
Split Dollar Details										
LLC 1 Summary										
Premium contributions made	87,579	87,282	86,885	86,486	85,984	81,816	-	-	-	-
QART purchases of LLC 1 shares	-	-	-	-	-	-	-	(306,752)	(503,864)	(79,116)
LLC 1 cumulative contributions	87,579	174,861	261,746	348,232	434,216	853,241	853,241	(207,399)	(2,304,777)	(3,996,485)
LLC 1 Value Owned by IRA	28,029	112,474	204,432	304,587	413,673	1,122,648	1,735,386	1,546,715	514,329	20,277
LLC 1 Death Benefit Owned by IRA	87,579	174,861	261,746	348,232	434,216	1,122,648	1,735,386	1,546,715	514,329	20,277
QART Summary										
QART outlay	1,599	1,896	2,293	2,692	3,194	7,362	6,378	320,308	531,415	162,109
Tax on Value of Economic Benefit	-	-	-	-	-	-	(6,378)	(13,556)	(27,551)	(82,993)
Net Outlay	1,599	1,896	2,293	2,692	3,194	7,362	-	306,752	503,864	79,116
LLC 1 Value Owned by QART	-	-	-	-	-	-	-	1,060,640	3,158,018	4,849,726
LLC 1 Death Benefit Owned by QART	9,985,039	9,977,248	9,977,366	9,986,081	10,004,228	10,000,000	9,387,262	9,575,933	10,608,319	11,102,371
Total Policy Values										
Premium	89,178	89,178	89,178	89,178	89,178	89,178	-	-	-	-
Cash Surrender Value	28,029	112,474	204,432	304,587	413,673	1,122,648	1,735,386	2,607,355	3,672,347	4,870,003
Death Benefit	10,072,618	10,152,109	10,239,112	10,334,313	10,438,444	11,122,648	11,122,648	11,122,648	11,122,648	11,122,648

DETAILS OF QUALIFIED PLANS

Qualified Account Replacement Trust

<u>YEAR</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2009</u>	<u>2014</u>	<u>2019</u>	<u>2024</u>	<u>2032</u>
John's age	55	56	57	58	59	64	69	74	79	87
Joint recalculated life expectancy	35.4	34.4	33.5	32.5	31.6	26.9	22.4	15.8	9.1	1.0
Total Plan balance	2,000,000	2,247,911	2,466,528	2,706,407	2,969,690	4,726,457	7,539,356	8,879,394	8,162,539	2,340,878
Required Minimum Distribtn (RMD)	-	-	-	-	-	-	-	507,867	834,211	1,157,514
Preferred distribution	-	-	-	-	-	-	-	-	-	-
Actual distribtn (max of RMD & Pref.)	-	-	-	-	-	-	-	507,867	834,211	1,157,514

COMPARISON OF PLANS: BENEFITS TO HEIRS

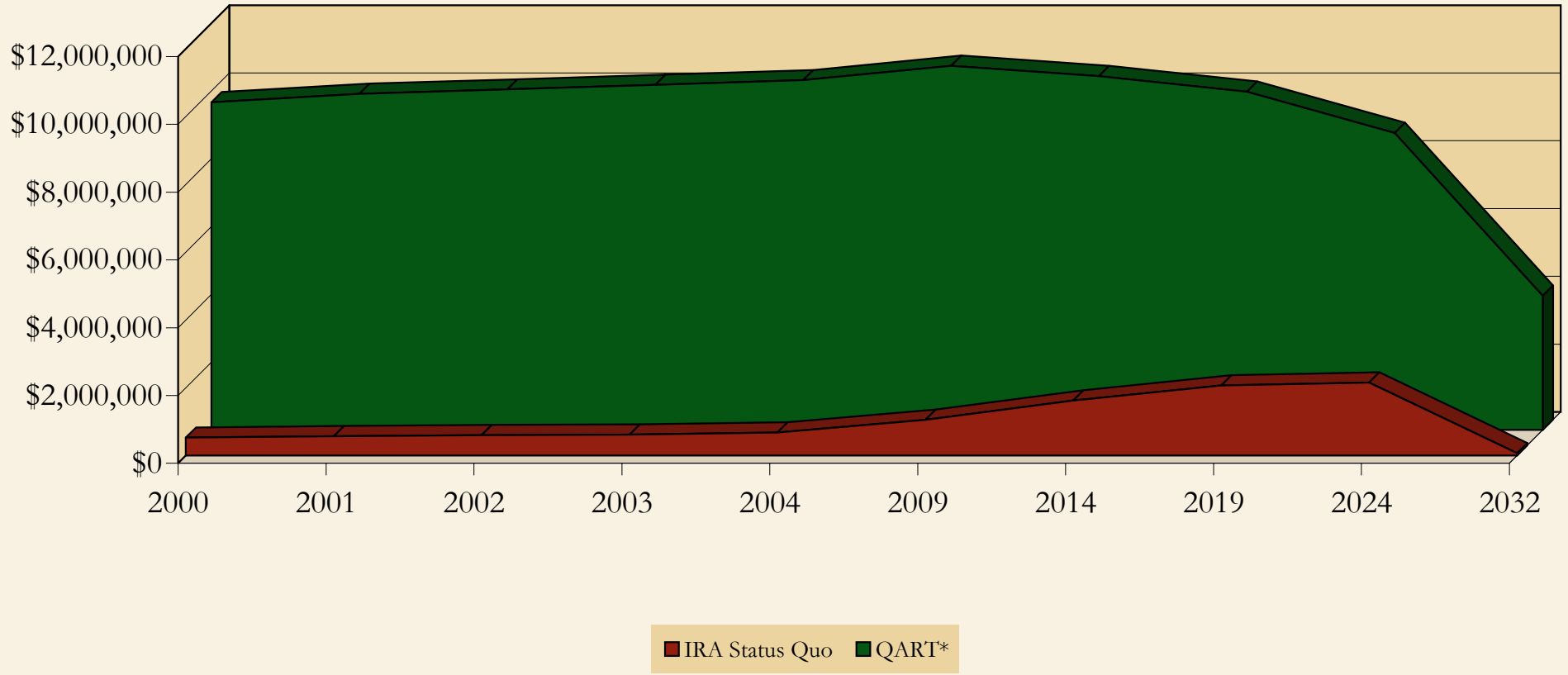
Qualified Account Replacement Trust

<u>YEAR</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2009</u>	<u>2014</u>	<u>2019</u>	<u>2024</u>	<u>2032</u>
Status Quo										
IRA Balance	2,000,000	2,254,312	2,479,743	2,727,718	3,000,490	4,832,319	7,782,497	10,188,392	10,777,855	353,630
Estate Taxes	(988,672)	(1,138,905)	(1,266,986)	(1,402,180)	(1,532,095)	(2,511,079)	(4,118,283)	(5,445,236)	(5,797,991)	(191,456)
IRD Taxes	(481,600)	(542,838)	(605,769)	(704,415)	(787,028)	(1,267,517)	(2,041,349)	(2,672,415)	(2,827,031)	(92,757)
Net Balance to Heirs	529,728	572,569	606,988	621,123	681,367	1,053,722	1,622,865	2,070,741	2,152,833	69,417
QART*										
Net value of LLC 2 units	2,079,000	2,079,000	2,079,000	2,079,000	2,079,000	2,265,966	3,504,382	4,352,256	4,509,739	6,481,628
Net Split-Dollar Benefit	10,044,589	10,039,635	10,034,680	10,029,726	10,024,771	10,000,000	9,387,262	9,575,933	10,608,319	11,102,371
Note payable to John and Joan	(1,871,100)	(1,494,139)	(1,289,080)	(1,072,117)	(842,638)	-	-	-	-	-
Net balance to Heirs	10,252,489	10,624,496	10,824,600	11,036,609	11,261,133	12,265,966	12,891,644	13,928,190	15,118,058	17,583,999
Less advantage from LLC 2 transfer to heirs (1)	(586,850)	(710,089)	(781,097)	(859,207)	(945,128)	(1,522,138)	(2,451,418)	(3,948,033)	(6,358,347)	(13,629,682)
Total Net Benefit to Heirs (1)	9,665,639	9,914,408	10,043,502	10,177,402	10,316,005	10,743,828	10,440,225	9,980,156	8,759,711	3,954,317
QART Leverage	9,135,911	9,341,839	9,436,514	9,556,279	9,634,638	9,690,106	8,817,360	7,909,415	6,606,878	3,884,900

GRAPHICAL COMPARISON OF PLANS: BENEFITS TO HEIRS

Qualified Account Replacement Trust

NET TO HEIRS



ENDNOTES

Qualified Account Replacement Trust

* QART includes \$3,000,000 of marketable securities purchased through a leveraged installment sale from the Smiths. The Smiths established LLC 2, funded it with \$3,000,000 of securities, and transferred the LLC 2 B shares to the QART through an installment sale. This sale is in addition to the LLC 1 shares held by the Smith IRA that participate in the split-dollar agreement.

(1) LLC 2 B shares with a gross value of \$297,000 were gifted to the QART. Also, the gross value of the remaining LLC 2 B shares purchased by the QART through the installment sale were worth \$2,673,000. Due to the 30% discount on the B shares, the actual amount repaid to the Smiths was only \$1,871,100. Therefore, the QART carried a advantage of \$1,098,900 to the Smiths heirs that did not exist in the Status Quo scenario. Therefore, this advantage, less estate taxes at 55%, is subtracted from the total benefits transferred to the heirs. For future years, the initial advantage of \$1,098,900, less estate taxes, is compounded at 10.0%. This annual rate of return is what the securities sold to the QART are assumed to earn each year.

Assumptions Used In Above Projections:

Item	Annual Yield	Annual Growth	Total Return
Marketable securities	2.0%	8.0%	10.0%
Qualified retirement plans	0.0%	10.0%	10.0%
LLC 1 shares	0.0%	10.0%	10.0%
LLC 2 shares	2.0%	8.0%	10.0%
Note from children's IDIT	6.0%	0.0%	6.0%
Valuation Adjustment on LLC 2 B shares		30%	
Client Name	John Smith		
Client Age	55		
Client Health	Healthy, Non-smoker		
Applicable Credit Amout Available	675,000		
Generation Skip Exclusion Available	1,030,000		
Available Gift Recipients	2		
Total Gift Exclusions Available	20,000		
Spouse Name	Joan Smith		
Spouse Age	53		
Spouse Health	Healthy, Non-smoker		
Applicable Credit Amout Available	675,000		
Generation Skip Exclusion Available	1,030,000		
Available Gift Recipients	2		
Total Gift Exclusions Available	20,000		

FACTORS AND ASSUMPTIONS OF PROPOSED STRATEGIES

SOLUTION 1 LIMITED LIABILITY COMPANIES	Input Values				Calculated Values
	<u>JOHN</u>	<u>JOAN</u>	<u>JOINT</u>	<u>TOTAL</u>	
Contribute to Limited Liability Company One (LLC 1)					
Marketable Securities					
IRA Securities	2,000,000	-	-	2,000,000	
Total Marketable Securities	2,000,000	-	-	2,000,000	2,000,000
Yield of Marketable Securities					0%
Growth of Marketable Securities					10%
Totals	2,000,000	-	-	2,000,000	
Total Value of Assets Contributed to LLC					\$ 2,000,000
Total Return of LLC Assets					10%
Discount applied to LLC B shares/total value				0%	2,000,000
Contribute to Limited Liability Company Two (LLC 2)					
Marketable Securities					
Stocks	1,500,000	1,500,000	-	3,000,000	
Total Marketable Securities	1,500,000	1,500,000	-	3,000,000	3,000,000
Yield of Marketable Securities					2%
Growth of Marketable Securities					8%
Totals	1,500,000	1,500,000	-	3,000,000	
Total Value of Assets Contributed to LLC					\$ 3,000,000
Total Return of LLC Assets					10%
Discount applied to LLC B shares/total value				30%	2,100,000

FACTORS AND ASSUMPTIONS OF PROPOSED STRATEGIES

SOLUTION 2

INSTALLMENT SALE TO QART

Sell LLC 2 B shares to QART

Initial gift of LLC 2 B shares to QART

207,900

LLC 2 B shares sold to QART

1,871,100

Interest rate

6.0%

Annual interest payment

112,266

of years for QART earnings to be taxable to client(s)

9

Investment account yield

2.9%

Investment account growth rate

11.4%

Total

14.3%

Variable Joint Life

Prepared For
John Smith
and
Joan Smith

Presented By
JERRY D NUERGE CLU, ChFC
Suite 310
127 W. Berry Street
Fort Wayne, IN 46774
(219) 426-1104, Ext. 0
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Variable Joint Life - Split Dollar

John Smith, Age 55, Male, Select
Joan Smith, Age 53, Female, Select

Initial Death Benefit Option B: Specified Amount plus Policy Value
Guideline Premium / Cash Value Corridor Test

Initial Specified Amount: \$10,000,000
Initial Annual Premium: \$89,178.00

10.66% Gross (10% Net) - Current Charges

Smith Family Split Dollar

Year	Annual Split Dollar Payment	Cumulative Split Dollar Payment	Annual Withdrawal/ Loan	Net Insurance	Net Cash Value	Annual Bonus
1	87,579	87,579	0	87,579	28,029	0
2	87,282	174,861	0	174,861	112,474	0
3	86,885	261,746	0	261,746	204,432	0
4	86,486	348,232	0	348,232	304,587	0
5	85,984	434,216	0	434,216	413,673	0
6	85,478	519,695	0	519,695	519,694	0
7	84,766	604,460	0	613,148	604,460	0
8	83,942	688,403	0	742,504	688,402	0
9	83,023	771,426	0	883,316	771,425	0
10	81,816	853,242	0	1,036,561	853,241	0
11	0	853,242	0	1,122,649	853,241	0
12	0	853,242	0	1,226,422	853,241	0
13	0	853,242	0	1,339,074	853,241	0
14	0	853,242	0	1,461,135	853,241	0
15	0	853,242	0	1,593,091	853,241	0
16	0	853,242	0	1,735,386	853,241	0
17	0	853,242	0	1,888,373	853,241	0
18	0	853,242	0	2,052,243	853,241	0
19	0	853,242	0	2,226,956	853,241	0
20	0	853,242	0	2,412,217	853,241	0

The purpose of this illustration is to show how the performance of the underlying investments could affect policy cash values and death benefits. The numbers shown here are not an estimate or a guarantee of future results. The future investment results shown are hypothetical and should not be deemed representative of past or future investment results. This illustration is not complete without all its pages. A prospectus describing the policy must accompany or precede this illustration. See the Policy Information pages for important information.

Variable Joint Life - Split Dollar

John Smith, Age 55, Male, Select
Joan Smith, Age 53, Female, Select

Initial Death Benefit Option B: Specified Amount plus Policy Value
Guideline Premium / Cash Value Corridor Test

Initial Specified Amount: \$10,000,000
Initial Annual Premium: \$89,178.00

10.66% Gross (10% Net) - Current Charges

Smith Family Split Dollar

Year	Annual Split Dollar Payment	Cumulative Split Dollar Payment	Annual Withdrawal/ Loan	Net Insurance	Net Cash Value	Annual Bonus
21	0	853,242	0	2,607,356	853,241	0
22	0	853,242	0	2,808,688	853,241	0
23	0	853,242	0	3,017,676	853,241	0
24	0	853,242	0	3,232,749	853,241	0
25	0	853,242	0	3,451,818	853,241	0
26	0	853,242	0	3,672,348	853,241	0
27	0	853,242	0	3,890,990	853,241	0
28	0	853,242	0	4,103,503	853,241	0
29	0	853,242	0	4,304,702	853,241	0
30	0	853,242	0	4,488,103	853,241	0
31	0	853,242	0	4,646,374	853,241	0
32	0	853,242	0	4,770,611	853,241	0
33	0	853,242	0	4,849,727	853,241	0
34	0	853,242	0	4,870,003	853,241	0
35	0	853,242	0	4,813,157	853,241	0
36	853,242CR	0	0	0	0	0
37	0	0	0	0	0	0
38	0	0	0	0	0	0
39	0	0	0	0	0	0
40	0	0	0	0	0	0

The purpose of this illustration is to show how the performance of the underlying investments could affect policy cash values and death benefits. The numbers shown here are not an estimate or a guarantee of future results. The future investment results shown are hypothetical and should not be deemed representative of past or future investment results. This illustration is not complete without all its pages. A prospectus describing the policy must accompany or precede this illustration. See the Policy Information pages for important information.

SPLIT DOLLAR VARIABLE JOINT LIFE BENEFIT LEDGER COLUMN DESCRIPTIONS

YEAR

Policy year being illustrated.

CORPORATION

ANNUAL SPLIT DOLLAR PAYMENT

Portion of the annual premium paid by the corporation.

CUMULATIVE SPLIT DOLLAR PAYMENT

The sum of the corporate annual split dollar payments.

ANNUAL WITHDRAWAL/LOAN

The total annual amount of withdrawals and/or loans made by the corporation.

NET INSURANCE

The death benefit payable to the corporation at the beginning of the policy year. Net Insurance reflects a reduction for any policy loan, including accrued loan interest.

NET CASH VALUE

The amount of cash available to the corporation upon surrender at the end of the policy year. It is equal to the invested assets less the surrender charge. A surrender charge applies only if the contract is surrendered during the first 10 policy years. Net Cash Value reflects a reduction for any policy loan, including accrued loan interest.

ANNUAL BONUS

The annual amount transferred from the corporation to the executive in the form of cash or cash value.

This may include:

- * the contribution that the executive is required to make toward the premium payments,
- * any cash value not recovered by the corporation at the time of roll out, and/or
- * additional amounts for the tax due on the bonus itself.

Variable Joint Life - Split Dollar

John Smith, Age 55, Male, Select
Joan Smith, Age 53, Female, Select

Initial Death Benefit Option B: Specified Amount plus Policy Value
Guideline Premium / Cash Value Corridor Test

Initial Specified Amount: \$10,000,000
Initial Annual Premium: \$89,178.00

10.66% Gross (10% Net) - Current Charges

John Smith

Year	Value of Economic Benefit	Executive Contribution	Tax on VEB	Annual Tax on Bonus	Annual After Tax Outlay	Net Insurance	Net Cash Value	Executive Income
1	1,599	1,599	0	0	1,599	9,992,681	0	0
2	1,896	1,896	0	0	1,896	9,978,017	0	0
3	2,293	2,293	0	0	2,293	9,970,624	0	0
4	2,692	2,692	0	0	2,692	9,971,141	0	0
5	3,194	3,194	0	0	3,194	9,980,357	0	0
6	3,700	3,700	0	0	3,700	9,999,010	12,780	0
7	4,409	4,412	0	0	4,412	10,019,404	57,370	0
8	5,208	5,236	0	0	5,236	10,014,450	114,240	0
9	6,106	6,155	0	0	6,155	10,009,496	184,462	0
10	7,303	7,362	0	0	7,362	10,004,541	269,406	0
11	8,600	0	3,406	0	3,406	10,000,000	373,180	0
12	10,094	0	3,997	0	3,997	9,896,226	485,831	0
13	11,838	0	4,688	0	4,688	9,783,575	607,892	0
14	13,816	0	5,471	0	5,471	9,661,514	739,849	0
15	16,105	0	6,378	0	6,378	9,529,558	882,144	0
16	18,775	0	7,435	0	7,435	9,387,263	1,035,130	0
17	21,885	0	8,667	0	8,667	9,234,276	1,199,000	0
18	25,397	0	10,057	0	10,057	9,070,406	1,373,714	0
19	29,534	0	11,695	0	11,695	8,895,692	1,558,975	0
20	34,232	0	13,556	0	13,556	8,710,432	1,754,113	0

The purpose of this illustration is to show how the performance of the underlying investments could affect policy cash values and death benefits. The numbers shown here are not an estimate or a guarantee of future results. The future investment results shown are hypothetical and should not be deemed representative of past or future investment results. This illustration is not complete without all its pages. A prospectus describing the policy must accompany or precede this illustration. See the Policy Information pages for important information.

Assumes tax bracket of 39.6%.

Variable Joint Life - Split Dollar

John Smith, Age 55, Male, Select
Joan Smith, Age 53, Female, Select

Initial Death Benefit Option B: Specified Amount plus Policy Value
Guideline Premium / Cash Value Corridor Test

Initial Specified Amount: \$10,000,000
Initial Annual Premium: \$89,178.00

10.66% Gross (10% Net) - Current Charges

John Smith

Year	Value of Economic Benefit	Executive Contribution	Tax on VEB	Annual Tax on Bonus	Annual After Tax Outlay	Net Insurance	Net Cash Value	Executive Income
21	39,596	0	15,680	0	15,680	8,515,293	1,955,446	0
22	45,727	0	18,108	0	18,108	8,313,961	2,164,433	0
23	52,682	0	20,862	0	20,862	8,104,973	2,379,506	0
24	60,594	0	23,995	0	23,995	7,889,900	2,598,576	0
25	69,574	0	27,551	0	27,551	7,670,831	2,819,105	0
26	79,793	0	31,598	0	31,598	7,450,301	3,037,747	0
27	91,336	0	36,169	0	36,169	7,231,659	3,250,261	0
28	104,515	0	41,388	0	41,388	7,019,146	3,451,459	0
29	119,587	0	47,356	0	47,356	6,817,947	3,634,861	0
30	136,937	0	54,227	0	54,227	6,634,545	3,793,131	0
31	157,179	0	62,243	0	62,243	6,476,275	3,917,368	0
32	180,970	0	71,664	0	71,664	6,352,038	3,996,484	0
33	209,578	0	82,993	0	82,993	6,272,922	4,016,761	0
34	244,603	0	96,863	0	96,863	6,252,645	3,959,914	0
35	288,596	0	114,284	0	114,284	6,309,492	3,801,403	0
36	0	853,242	0	0	853,242	11,122,649	4,360,595	0
37	0	0	0	0	0	11,122,649	3,883,015	0
38	0	0	0	0	0	11,122,649	3,152,770	0
39	0	0	0	0	0	11,122,649	2,068,262	0
40	0	0	0	0	0	11,122,649	477,726	0

The purpose of this illustration is to show how the performance of the underlying investments could affect policy cash values and death benefits. The numbers shown here are not an estimate or a guarantee of future results. The future investment results shown are hypothetical and should not be deemed representative of past or future investment results. This illustration is not complete without all its pages. A prospectus describing the policy must accompany or precede this illustration. See the Policy Information pages for important information.

Assumes tax bracket of 39.6%.

SPLIT DOLLAR VARIABLE JOINT LIFE BENEFIT LEDGER COLUMN DESCRIPTIONS

EMPLOYEE

VALUE OF ECONOMIC BENEFIT (VEB)

The value of the insurance benefit provided under the plan is determined by multiplying the executive's net insurance amount by the lowest available term rate.

EXECUTIVE CONTRIBUTION

The executive's contribution toward the premium payments.

TAX ON VEB

The tax payable on the imputed income. Imputed income is the value of the economic benefit less the executive's contribution.

ANNUAL TAX ON BONUS

The tax payable on the annual bonus received by the executive from the corporation.

ANNUAL AFTER TAX OUTLAY

The after tax outlay includes:

- * the executive's contribution, and
- * tax on the value of the economic benefit, and
- * annual tax on bonus:
- * less the annual cash bonus from the corporation, and
- * less the executive's annual withdrawals/loans, if any.

NET INSURANCE

The death benefit payable to the executive at the beginning of the policy year. Net Insurance reflects a reduction for any policy loan, including accrued loan interest.

NET CASH VALUE

The amount of cash available to the executive upon surrender at the end of the policy year. It is equal to the invested assets less the surrender charge. A surrender charge applies only if the contract is surrendered during the first 10 policy years. Net Cash Value reflects a reduction for any policy loan, including accrued loan interest.

EXECUTIVE INCOME

The annual amount taken from the policy by the executive through withdrawals and/or loans. Withdrawals to pay taxes, loan interest and / or loan repayment are not included.

Variable Joint Life

John Smith, Age 55, Male, Select
Joan Smith, Age 53, Female, Select

Initial Death Benefit Option B: Specified Amount plus Policy Value
Guideline Premium / Cash Value Corridor Test

Initial Specified Amount: \$10,000,000
Initial Annual Premium: \$89,178.00

10.66% Gross (10% Net) - Current Charges

Year	Net Insurance	Annual Outlay	Premium	Interest Paid	Tax Paid	Annual Withdrawal/ Loan	Invested Assets	Net Cash Value
1	10,072,618	89,178	89,178	0	0	0	72,618	28,029
2	10,152,109	89,178	89,178	0	0	0	152,109	112,474
3	10,239,112	89,178	89,178	0	0	0	239,112	204,432
4	10,334,313	89,178	89,178	0	0	0	334,313	304,587
5	10,438,444	89,178	89,178	0	0	0	438,444	413,673
6	10,552,292	89,178	89,178	0	0	0	552,292	532,475
7	10,676,693	89,178	89,178	0	0	0	676,693	661,830
8	10,812,551	89,178	89,178	0	0	0	812,551	802,642
9	10,960,842	89,178	89,178	0	0	0	960,842	955,888
10	11,122,648	89,178	89,178	0	0	0	1,122,648	1,122,648
11	11,122,648	0	0	0	0	0	1,226,422	1,226,422
12	11,122,648	0	0	0	0	0	1,339,073	1,339,073
13	11,122,648	0	0	0	0	0	1,461,134	1,461,134
14	11,122,648	0	0	0	0	0	1,593,090	1,593,090
15	11,122,648	0	0	0	0	0	1,735,386	1,735,386
16	11,122,648	0	0	0	0	0	1,888,372	1,888,372
17	11,122,648	0	0	0	0	0	2,052,242	2,052,242
18	11,122,648	0	0	0	0	0	2,226,956	2,226,956
19	11,122,648	0	0	0	0	0	2,412,217	2,412,217
20	11,122,648	0	0	0	0	0	2,607,355	2,607,355

The purpose of this illustration is to show how the performance of the underlying investments could affect policy cash values and death benefits. The numbers shown here are not an estimate or a guarantee of future results. The future investment results shown are hypothetical and should not be deemed representative of past or future investment results. This illustration is not complete without all its pages. A prospectus describing the policy must accompany or precede this illustration. See the Policy Information pages for important information.

Variable Joint Life

John Smith, Age 55, Male, Select
Joan Smith, Age 53, Female, Select

Initial Death Benefit Option B: Specified Amount plus Policy Value
Guideline Premium / Cash Value Corridor Test

Initial Specified Amount: \$10,000,000
Initial Annual Premium: \$89,178.00

10.66% Gross (10% Net) - Current Charges

Year	Net Insurance	Annual Outlay	Premium	Interest Paid	Tax Paid	Annual Withdrawal/ Loan	Invested Assets	Net Cash Value
21	11,122,648	0	0	0	0	0	2,808,688	2,808,688
22	11,122,648	0	0	0	0	0	3,017,675	3,017,675
23	11,122,648	0	0	0	0	0	3,232,748	3,232,748
24	11,122,648	0	0	0	0	0	3,451,817	3,451,817
25	11,122,648	0	0	0	0	0	3,672,347	3,672,347
26	11,122,648	0	0	0	0	0	3,890,989	3,890,989
27	11,122,648	0	0	0	0	0	4,103,503	4,103,503
28	11,122,648	0	0	0	0	0	4,304,701	4,304,701
29	11,122,648	0	0	0	0	0	4,488,103	4,488,103
30	11,122,648	0	0	0	0	0	4,646,373	4,646,373
31	11,122,648	0	0	0	0	0	4,770,610	4,770,610
32	11,122,648	0	0	0	0	0	4,849,726	4,849,726
33	11,122,648	0	0	0	0	0	4,870,003	4,870,003
34	11,122,648	0	0	0	0	0	4,813,156	4,813,156
35	11,122,648	0	0	0	0	0	4,654,645	4,654,645
36	11,122,648	0	0	0	0	0	4,360,595	4,360,595
37	11,122,648	0	0	0	0	0	3,883,015	3,883,015
38	11,122,648	0	0	0	0	0	3,152,770	3,152,770
39	11,122,648	0	0	0	0	0	2,068,262	2,068,262
40	11,122,648	0	0	0	0	0	477,726	477,726

The purpose of this illustration is to show how the performance of the underlying investments could affect policy cash values and death benefits. The numbers shown here are not an estimate or a guarantee of future results. The future investment results shown are hypothetical and should not be deemed representative of past or future investment results. This illustration is not complete without all its pages. A prospectus describing the policy must accompany or precede this illustration. See the Policy Information pages for important information.

VARIABLE JOINT LIFE COLUMN DESCRIPTIONS

YEAR

Policy year being illustrated.

NET INSURANCE

The death benefit payable at the end of the policy year. Net Insurance reflects a reduction for any policy loan, including accrued loan interest.

ANNUAL OUTLAY

The sum of:

- * the premium paid
- * loan interest paid in cash
- * tax on any gain that is recognized and paid in cash
- * any amount paid that is used for loan repayment
- * less withdrawals and loans

All of these transactions are assumed to occur at the beginning of the policy year.

PREMIUM

The illustrated amount to be paid to the insurance company. This amount, after deductions for premium expense charges, is allocated to the Division(s).

INTEREST PAID

The portion of the interest due as of the beginning of the year which is not added to the loan balance.

TAX PAID

The tax on gain (withdrawals in excess of basis) that is paid in cash or by withdrawal.

ANNUAL WITHDRAWAL/LOAN

The total annual amount of withdrawals and/or loans.

INVESTED ASSETS

The amount in the Division(s) at the end of the policy year. Invested Assets reflects a reduction for any policy loan, including accrued loan interest.

NET CASH VALUE

The amount of cash available upon surrender at the end of the policy year. It is equal to the invested assets less the surrender charge. A surrender charge applies only if the contract is surrendered during the first 10 policy years. Net Cash Value reflects a reduction for any policy loan, including accrued loan interest.