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The reverse endowment model: increasing a business family's philanthropic planned giving through private placement life insurance and dynasty trusts

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THE REVERSE ENDOWMENT MODEL: INCREASING A BUSINESS FAMILY'S PHILANTHROPIC PLANNED GIVING THROUGH PRIVATE PLACEMENT LIFE INSURANCE AND DYNASTY TRUSTS

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DEDICATION

This research project is dedicated to entrepreneurs and business families who impact their communities by providing employment opportunities and direct investments into privately owned businesses and real estate development. A special dedication is given to those business families that support their localities by providing leadership and generosity to the poor and vulnerable. This research is also dedicated to those business leaders and dignitaries abroad who despise corruption and bribery and are attracted to jurisdictions that have a stable banking and financial infrastructure, respect private property, and uphold the rule of law.

This research is dedicated to nonprofit organizations tirelessly working to improve the lives of others and serve the most vulnerable. I hope this project will encourage nonprofits to serve and educate their major donor constituency by helping them understand the beneficial elements of the Reverse Endowment Model and thereby increase generosity and planned giving. Finally, this research is dedicated to Business Family Institutes at notable universities around the world that are well positioned to educate business families on the topics and practical knowledge within this research.

For the business family, the Reverse Endowment Model is a recipe for enhanced planned giving while simultaneously building family wealth across three generations.

"A good man leaves an inheritance to his children's children."

Solomon, King of Israel (c. 990-931 BCE)

ACKNOWLEDGMENTS

I would like to thank and acknowledge my academic supervisor, James DiLellio, Ph.D., for his meticulous attention to detail. The revision process was rigorous and laborious, but I am grateful for the constructive feedback and the scientific method. Also, I would like to thank and acknowledge my secondary advisors, Bobbi Thomason, Ph.D. and Zhike Lei, Ph.D., for their support and oversight of this research. Finally, I would like to thank and acknowledge Garrett Pendergraft, Ph.D., as the external reviewer.

VITA

Kristofer R. Gray is a Certified Financial Planner (CFP) which is a formal recognition of expertise in the areas of financial planning, taxes, insurance, estate planning, and retirement. The designation is awarded to individuals who successfully complete the CFP Board's initial exams and are held to a standard of ongoing continuing education to sustain their skills and certification. Kristofer holds a master's degree in Public Policy from the University of Washington and has worked as a financial planner for over 20 years. He is the Principal and Founder of a registered investment advisory practice with locations in multiple states. He serves as a fiduciary advisor for an array of both HNW and UHNW families and helps them create a roadmap to address both the qualitative and quantitative challenges related to the cross-generational transfer of wealth.

Kristofer is motivated to gain a better understanding of PPLI and the tax alpha it can generate for different populations. He has a severely handicapped son, along with three other children, and has felt the need for elaborate estate planning to assure that potential future financial obligations related to the cost of care for his dependents would be sufficiently provided for through extensive planning and preparation. Kristofer has also established a multi-family office that provides educational retreats for affluent families to discuss best-practices on the topics of family, health, and wealth.

Kristofer is frequently involved in policy discussions and serves on the board of directors for the Association of Washington Business, otherwise known as the Washington State Chamber of Commerce. He frequently conducts educational workshops on year-end tax and investment planning for business owners and executives.

ABSTRACT

Private Placement Life Insurance (PPLI) is the crown jewel of insurance planning for the ultra-high net-worth single-family office. However, there remains an asymmetry of knowledge regarding the arrangement between ultra-high net-worth (UHNW) and high net-worth (HNW) business families. Due to recent tax changes (2017 Tax Cut and Jobs Act) and significant government economic stimulus related to COVID-19, a unique application of PPLI for HNW with an alternative policy structure, which we call the Reverse Endowment Model, may create an opportunity for business families to increase their planned giving and still pass the same amount of inheritance assets to their heirs. The research focuses on identifying an unrecognized opportunity among HNW business families and an analysis of how the arrangement is best architected. A cross-generational quantitative analysis illustrates the feasibility of the conceptual model. Using surveys and interviews, I further establish the market demand and supply of this unique and innovative estate planning approach.

Keywords: private placement life insurance, dynasty trust, donor advised fund, family foundation, qualified retirement plan

CHAPTER 1: INTRODUCTION

Overview

> The lack of high net worth PPLI premium volume to this point in time has nothing to do with the viability and planning and investment benefits of PPLI relative to retail variable insurance products, but rather results from the lack of agent compensation for selling the product. It is the most complex insurance product that compensates the life insurance agent like an investment product. (Nowotny, 2012, p. 51)

This research project seeks to understand the dislocation between the supply and demand related to private placement life insurance (PPLI) and dynasty trust arrangements among high net worth (HNW) business families. This dislocation seems to be accentuated by an asymmetry of knowledge related to sophisticated planning techniques among HNW and ultra-high net worth (UHNW) business families (and their advisors). The market equilibrium of supply and demand appears to be hindered by compensation structures that disincentive the supply side. In the end, I am hoping to understand the viability of these sophisticated constructs and their application for a 'main street' business family with an interest towards philanthropy and planned giving. Specifically, I am researching the feasibility of using private placement life insurance and dynasty trusts to enhance the charitable planned giving goals of a family. I recognize that there are many ways for a charitably inclined donor to make gifts to charity and this research is grounded in the theory of a leveraged asset transfer through the use of life insurance in planned giving to philanthropic causes (Storm, 2006). This contribution highlighted how life insurance can be an efficient way to maximize the distribution of assets to one's family or favorite charity. In essence, when combined with trust structures, life insurance can help increase the amount of funds being transferred to heirs or organizations. This amplification effect is otherwise known as a leveraged asset transfer. Further, if one anticipates that income and estate taxes will substantially increase in the future, permanent life insurance can be utilized in the planned giving process to minimize unnecessary tax obligations. Storm (2006) was clear to highlight various charitable giving techniques that may incorporate the use of life insurance to help the donor preserve personal wealth while making significant gifts to charity. This research builds upon these efforts by providing an integrated visual map as well as a mathematical analysis to measure the amplification of wealth through a research grounded, long-term planned giving approach discussed in Chapter 5. In addition, this research builds upon the theory of a leveraged asset transfer while integrating numerous cross-generational planning tools. The primary contribution of this research to the theory is the unique integration of planned giving technical components assembled together in an innovative and synergistic manner.

Further, while many business families are faced with the unfortunate reality that most family wealth breaks down over three generations, I put forward a new model as a blueprint to reverse course and build upon each generation's efforts and impact. The model incorporates a non-modified endowment (non-MEC) contract to create a testamentary endowment for the family foundation and an additional pool of capital within a dynasty trust incorporating a family bank concept. An endowment model would typically emphasize diversification and active management of equity-oriented illiquid assets (Chambers & Dimson, 2015). PPLI allows for long-term illiquid private equity investments to build cash value inside the policy and simultaneously increase the death benefit thereby creating a leveraged asset transfer. For first generation wealth creators, this represents a way to build an endowment for successive generations using a non-MEC structure. Unlike a traditional endowment, whereby the principal value is restricted from use, the non-MEC structure allows for access to the principal during one's lifetime, provides for asset protection, and amplifies the overall value at death.

This cross-generational process of building wealth for planned giving has the potential to unite the business family in purpose while providing for subsequent family leaders. The Reverse Endowment Model, introduced in Chapter 5, embraces the illiquidity premium often associated with alternative investments housed within a traditional endowment model. Indeed, an endowment model at both the family foundation and family bank are the testamentary goals of the initial wealth creators in the model. First generation wealth creation reverses the typical endowment process through a leveraged asset transfer by creating significant pools of capital for the family and charities through a series of smaller payment streams being contributed in the form of premium payments. In the model, a small $3M dollar seed grows into a multi-hundred-million-dollar endowment in the family bank and a family foundation capitalized with over $100M for planned giving. The goal of the model is to transfer opportunities and generosity over multiple generations, while acknowledging the need for providing ongoing qualitative and quantitative support to each generation.

Problem Addressed

Private Placement Life Insurance (PPLI) is commonly used in the financial architecture of the UHNW, defined by having over $30M net worth. Deferred compensation plans can also be structured utilizing PPLI. This is often the case with insurance company owned life insurance (ICOLI) and bank owned life insurance (BOLI). Small to mid-sized business families and HNW ($1M to $30M) seem uniquely suited for PPLI, but most have never heard of it and could be missing out on a legitimate arrangement that could enhance their planned giving. Although the market research is nascent, it seems that many HNW business families are interested in understanding techniques to increase creditor protection, minimize taxes, and invest in alternative assets such as private equity. I believe that there remains an asymmetry of knowledge between UHNW family offices and HNW advisors regarding PPLI, as the PPLI arrangement is highly complex and often difficult for advisors to communicate. Insurance agents and advisors to the HNW do not get paid a traditional commission to facilitate a PPLI arrangement, which seems to have slowed the adoption rate among their business family clients. The academic literature is nascent and provides limited clarity on how the structure is currently utilized by UHNW, deferred compensation plans, and banks. Furthermore, there seems to be no literature on how to utilize the PPLI construct to increase a family's planned giving. Unfortunately, this leaves the small to mid-sized business families and the HNW, who seem uniquely suited for PPLI, without the knowledge or tools that are commonplace among the UHNW family office.

Research Questions

- Among the HNW population, does there exist a latent interest in the features and benefits of a PPLI arrangement?
- Why does PPLI seem underutilized by high net-worth business families, while the arrangement appears much more common among UHNW family offices?
- How is PPLI commonly structured for U.S. UHNW individuals, U.S. HNW individuals, and foreign UHNW individuals?
- Is it possible for a business family to structure a PPLI policy to create the same after-tax financial outputs (retirement income and inheritance to children) as a standard account arrangement, with additional assets going to 501(c)3 charities for enhanced planned giving?

The first research question is uncovered through a survey instrument and addresses the market demand for PPLI and the corresponding sophisticated tax, trust, and estate planning that typically accompany the arrangement. The second question is investigative and general in nature, but important to understand the disconnect. It is addressed in the professional interview section along with the common structuring of the PPLI arrangement for the different demographics. The interviews were conducted among experienced thought leaders and professional service providers in the PPLI arena and were remarkably helpful to understand the technical nuances and best practices of the arrangement. Finally, the crux of the research is an analytical model demonstrating the mathematical superiority of the PPLI arrangement versus a traditional approach to estate planning. The analytical model reveals how a business family can structure their financial affairs to provide for their children and grandchildren while having a significant planned giving in their local community or other philanthropic endeavors.

Significance of the Proposed Research

The purpose of this study is to understand and describe the viability of PPLI and dynasty trusts for HNW business families and to measure if it could be used to increase their planned giving. The significance of the research is fivefold: (1) Knowledge: there exists a gap in the academic and practitioner literature as it relates to HNW business families utilizing PPLI as a tool for planned giving; (2) Innovation: I am interested in testing the viability of a conceptual model that combines PPLI, family foundations, and private equity investments to increase the HNW business family's planned giving; (3) Planned Giving: the homeless, vulnerable, and marginalized stand to benefit when significant assets are placed into the hands of effective, non-governmental organizations. Planned giving for this study will be measured by funds contributed to qualified 501(c)3 charities. Thoughtful financial architecting among the HNW can increase the planned giving of business families and reduce the burden on the government to provide certain social services. If successful, this innovation can help philanthropically minded HNW implement cross-generational plans for increased planned giving, while still delivering retirement income and inheritances for their children; (4) Educational Opportunity: I hope to supply educational content for business family institutes such as the Business Families Institute at Singapore Management University or other similar business family institutes; (5) Unrealized Market Opportunity: The population of the global HNW market is 100 times the size of the global UHNW market. According to the Wealth-X High Net Worth Handbook of 2019, the number of individuals with net assets of $1M-$30M totaled 22.4 million. This unrecognized market demand among the HNW could represent a significant market opportunity for life insurance companies, alternative asset managers, and planned giving departments of non-governmental organizations.

The timing of this project is serendipitous. The world is grappling with the COVID-19 virus, thus social distancing guidelines has increased the appetite for online education and virtual consulting. I believe that the demand for high-quality educational content curated for business families will continue to grow. This research is important because it helps to lay the groundwork for a virtual business family institute whereby business-related knowledge can flourish among families of influence.

Finally, the conceptual layout can act as an estate planning blueprint for business families who desire to maximize the possibilities of tax, investment, and legal planning to increase their planned giving while providing for their personal income in retirement and still transferring a significant amount of wealth to their children and grandchildren in a highly efficient manner.

CHAPTER 2: LITERATURE REVIEW

Introduction & Background: What is PPLI?

PPLI was originally conceived as a structure for the U.S. corporate-owned life insurance (COLI) market. It was designed to be an improved funding vehicle for non-qualified deferred compensation plans generally covering the executive suite of medium to large enterprises. The new structure was intended to lower the insurance agent's commission, and thereby increase the efficiency of the underlying separate account investments (Lawson & Loury, 2005). These deferred compensation arrangements utilizing COLI and bank owned life insurance (BOLI) are often institutionally managed asset pools that exceed $100M USD.

In the late 1990's, not long after the COLI market shifted to the PPLI construct, UHNW individuals began following suit. Initially, these investors arranged offshore PPLI contracts with small insurance carriers willing to utilize tax-inefficient hedge funds as a funding vehicle (Cole & Kailus, 2002). Bermuda and the Cayman Islands were the most robust offshore jurisdictions, with Liechtenstein and Ireland on the heels. This was primarily due to a favorable regulatory environment with strong privacy and asset protection laws.

Manzke (1999) brought to the literature the opportunity to marry the income and estate tax efficiencies of life insurance with hedge fund investing. Manzke (1999) discussed the tax regulations, policy structure, and investment requirements that must be adhered to when placing hedge funds inside a PPLI contract. Hegde funds were an ideal engine for insurance products of this kind due to their tax inefficiency (generating most of their gains from short-term trading) and their absolute return-oriented investment strategy.

Other scholars supported the notion of offshore investment constructs utilizing hedge funds within PPLI (Blazzard & Stone, 1999; Cohen et al., 1999). Blazzard and Stone (1999) discussed the status of offshore variable insurance products and explained how a PPLI contract could be set up in Bermuda. Their research was an important contribution because it added to the discussion about the credibility and broad offshore technical parameters of the PPLI construct, such as the creation of variable insurance products with segregated asset accounts.

Cohen et al. (1999) shed light on the income tax savings, asset protection, and the estate planning benefits of a PPLI contract. They explained the benefits of tax-efficient investing using private placement variable life insurance and annuities. They made the initial foray into the individual UHNW market possible by explaining the benefits to the individual policyholder. They described private placement variable life insurance as a construct where the policy's cash value would be invested in a separate account managed for the insurance company by an investment manager, which was most often a hedge fund manager.

Alternative Investments and PPLI

Alternative assets pair well with a PPLI contract since PPLI is a form of cash value variable universal life insurance that is offered privately, rather than through a public offering. Both are available only to accredited U.S. investors who must meet one of two income requirements, according to the U.S. Securities & Exchange Commission (SEC, 2021): a net-worth of at least $1M (excluding the value of one's primary residence) or income of at least $200K each year for the last two years ($300K combined income if married) with an expectation to earn the same amount in the current calendar year.

Alternative investments are assets that fall outside the traditional publicly traded investment categories of stocks, bonds, and cash. Institutional investors, such as university endowments, sovereign wealth funds, private foundations, and pension trustees utilize alternative assets heavily because of their low correlation with publicly traded investments. Alternative investments are unregulated by the SEC and most commonly include private equity, real estate, private credit, hedge funds, and commodities.

Padgett (2009) wrote about the advantages of PPLI. Padgett (2009) asserted that if an individual investor already has a large commitment or interest in alternative investments, such as private equity or hedge funds, and does not anticipate needing the principal returned for spending needs, then that client should consider a PPLI contract for a material portion of those assets to shield them from income taxation and to participate in the benefits of a life insurance contract such as greater creditor protection and the elimination of K-1 tax reporting. This contribution explained the economics of a private placement insurance or annuity contract. Wells (2009) wrote that hedge funds and private equity are both well suited for the PPLI structure because of the long-term nature of the insurance contract. Wells (2009) summarized the utility of the PPLI contract as a wealth management tool by describing its low cost structure, availability to invest in alternative assets, ability to grow free from taxes, and ability to distribute to the designated beneficiary free from income tax. These attributes make the PPLI arrangement like a Roth IRA, only without the funding limitations based on higher income levels.

In an interview with Mitch Lee from KKR, he indicated that the firm has been active in creating an insurance dedicated fund for PPLI use with COLI and BOLI clients (M. Lee, personal communication, 2019). Mr. Lee co-leads KKR’s efforts in insurance company business development and helps provide solutions for KKR’s insurance company asset management clients. It is important to note that the modern private equity industry is largely credited to a handful of American corporate financiers, most notably Jerome Kohlberg, Henry Kravis, and George Roberts, who established a private equity firm titled KKR. The trio began making a series of investments in family-run businesses, which faced financial and succession issues in the

1960s. KKR's acquisition of Orkin Exterminating Company in 1964 is considered the first leveraged buyout (LBO) transaction in U.S. history (Artivest, 2019). According to Mr. Lee, the KKR insurance-dedicated fund (IDF) was recently established and competes with other alternative asset managers, such as Blackstone, Apollo, and Golub.

Blackstone, the world's largest alternative investment firm in the world, with total AUM of around $439 billion, uses iCapital's technology to improve and expand access to alternatives in the private wealth segment among the HNW. iCapital Network is the financial technology platform democratizing alternative investments with complete tech-based solutions for investors, advisors, and asset managers. The firm's flagship platform offers HNW investors and independent wealth advisors a curated menu of private equity and hedge funds at lower minimums with a full suite of due diligence and administrative support in a secure digital environment. Lawrence Calcano, CEO of iCapital said, "Increasingly, we are seeing a melding of two worlds: finance and technology. With the rise of fintech, the financial services industry is being transformed. We are particularly excited to be at the forefront of that opportunity for the alternative investments sector" (iCapital Network, 2018, para. 4). For practitioners, these improvements through the combination of technology and finance can help to support the unique subscription, administration, and reporting processes for private equity, private credit, hedge funds, and other alternative investments.

During this research, iCapital acquired Artivest in May 2020, which solidified their global position as the leading fintech platform offering private equity, private credit, hedge funds, and other alternative investments. This strategic move by iCapital increased their client assets to over $55 billion and positioned themselves a key player in the distribution or supply side of alternative investment opportunities among the HNW.

Like Blackstone investing into iCapital, KKR had invested into a similar fintech company called Artivest. Through Artivest's fintech platform, advisors and investors could access a vetted selection of private equity and hedge funds. Furthermore, they could view manager presentations, data room, and virtual pitch book under one login. Advisors were able to complete investor qualification and secure fund allocations. The entire subscription process was online and could be completed virtually with clients. Artivest allowed advisors to monitor fund performance and manage capital call and distribution activity across multiple funds and clients.

According to the Wharton Global Family Alliance 2018 Family Office Benchmarking Report, there is significant appetite among sophisticated investors and family offices for private equity, private credit, and direct leveraged real estate. The executive summary notes that asset allocation trends point to growth in private equity and principal direct investment and a continuing decline in allocation to hedge funds (Wharton, 2019).

With the advances in technology, evergreen product structuring, and lower minimums, private equity investments represent one of the most ideal asset classes for PPLI. Evergreen structuring is an open-ended fund structure with no termination date and capital can be raised, repaid, or transferred on an ongoing basis. Due to their flexibility, no end date, and ability to raise more capital, evergreen funds can be an effective vehicle for long-term capital appreciation. Historically, equities outperform bonds or cash in the traditional investment arena over a long period of time. This would leave investment guru's such as Warren Buffet to make recommendations for the average American to invest in the Standard and Poor's 500 index (S&P 500). A passive investment into the S&P 500 is incredibly tax efficient due to its long-term hold nature and has equity diversification across approximately 500 U.S. companies. Although Mr. Buffet's wisdom may be appropriate for the average American, the story might be different for the accredited investor who has access to alternative investments. When you overlay the Cambridge Associates LLC U.S. Private Equity Index over the S&P 500 over a 25-year period, the picture shows outperformance of private equity in relationship to the S&P 500. Over the 25-year time horizon, the Cambridge Associates LLC U.S. Private Equity Index averaged 13.21%, while the S&P 500 only averaged 8.33% return (Cambridge Associates, 2019). The data represented includes the average historical performance of over 2,000 fund managers and over 7,500 funds. In the private equity markets, a firm's reputation (experience, information network, board of directors professional network, and direct assistance to the underlying portfolio firms) can provide better negotiating terms and could result in higher profits for the investors (Hsu, 2004). Nanda et al (2020) supports the notion that initial success by a private equity firm improves their access to deal flow, which can also raise the quality of subsequent investments.

Venture capital is recognized as a smaller subset within the broader private equity definition and is indicative of an earlier stage investment in a business. Traditional private equity investments span across later stage business investments, but still pre-IPO, and investors can invest through 1) direct investment, 2) primary private equity funds, 3) secondary private equity funds, and 4) co-investment private equity funds. Persistency of performance among upper quartile venture capital managers was noted by Harris et al. (2020) using cash-flow data sourced from Burgiss' large sample of institutional investors.

Asset Protection

Asset protection afforded by a PPLI contract is one of the major benefits and one of the principal drivers for individual inquiry. Unlike a direct investment in a S&P 500 index fund, life insurance represents one of the few financial constructs that is inherently protected from creditor claims. If the insured purchased the policy prior to any knowledge about future claims, the assets cannot be seized (Wells, 2009). That is, any premiums contributed to the PPLI policy is completely protected from bankruptcy, debtors, claimants, etc. Section 522(d)(8) of the U.S. Bankruptcy Code provides federal bankruptcy protection for life insurance policies. From a public policy perspective, life insurance is a favored asset class for heightened creditor protection because it is considered essential for the debtor and/or the debtor's family to maintain a minimum level of financial well-being and avoid becoming a burden to the state (Lowry, 2005).

The PPLI arrangement within a variable universal life chassis creates two levels of asset protection. The cash value of the policy is invested in a separate account of the insurance company and are not exposed to creditor's claims against the insurance company arising out of any of the insurer's other operations, and the separate account is generally protected from the claims of creditors of the policyholder (Cohen et al., 1999). There is a difference between fixed (general account) insurance products and variable insurance products. The contractual promises of the fixed insurance policy are supported by the insurer's general account assets, which are invested according to state insurance regulation. In the variable universal life arrangement, the separate account assets, while also assets of the insurer, are segregated by state insurance statutes from the claims of the insurer's general creditors (Nowotny, 2012). Thus, while policyholders are exposed to risk of default by the insurance company, protections are in place to mitigate this risk. Proper due diligence should be performed prior to any private placement of capital.

At the individual PPLI policyholder level, the asset protection afforded varies widely on a state-by-state basis. Asset protection trusts and dynasty trusts can be integrated with a PPLI policy at either the ownership or beneficiary level to enhance asset protection. Insurance is regulated on a state-by-state basis, and each jurisdiction affords varying levels of creditor protection. At present, the states with the most generous asset protection laws for PPLI appear to be Arizona, Connecticut, Delaware, Florida, Idaho, Kentucky, Louisiana, Massachusetts, Michigan, New Mexico, Ohio, Oklahoma, Texas, and Washington. As an example, in Washington, a beneficiary's interest in proceeds and avails is wholly protected from all creditors according to the Wash. Rev. Code Section 48.18.410.

Offshore/Onshore Insurance Carriers

In the late 1990's, PPLI products were arranged offshore with small insurance carriers in Bermuda and the Cayman Islands that were willing to put policy assets into a hedge fund. This was because states were slow to lift restrictions on insurance companies investing in hedge funds (Cole & Kailus, 2002). In response to the regulatory restrictions, hedge fund investors and managers worked with consultants to create customized offshore arrangements for clients.

Establishing an offshore PPLI contract exempts the policyholder from a federal tax known as the Deferred Acquisition Cost (DAC) on the policy which is generally less than a 1% premium load/charge. Further, offshore policyholders are not subject to state premium taxes, which can vary from 1% to 3% of the premium depending on the jurisdiction. South Dakota, Alaska, and Delaware have the lowest premium taxes which are all below 1%, while the highest premium taxes are found in California and Nevada. For an expanded list of selected state premium taxes, see King and McDowell (2011, p. 26).

The same rules concerning tax deferral or elimination apply to both domestic and offshore arrangements. A life insurance policy issued by an offshore foreign company can be subject to a U.S. excise tax of 1% (Cohen et al., 1999). However, when choosing an offshore insurance carrier, it is important that the insurer has made an election as a Section 953(d) classification of the Internal Revenue Code, which allows the insurance company to be treated as a U.S. taxpayer (Nowotny, 2012). Under Section 953(d), the burden to pay the federal excise tax is removed because the policy of insurance is no longer considered as having been issued by a foreign corporation. The policy would still be subject to the DAC of approximately 1% of premiums or deposits. The only tax benefit for a U.S. citizen to purchase an offshore policy, now that onshore options are available, is to save on the state premium tax, which can be incredibly small in some jurisdictions (e.g., South Dakota is 8/100ths of 1% or 8 basis points).

Jurisdictional risk is an important consideration when choosing an offshore location. Political and economic stability are critical factors in the decision. Since 2012, Puerto Rico, a U.S. Commonwealth, has intrigued policyholders that were interested in an 'onshore offshore' jurisdiction, whereby the policyholder is not subject to the Report of Foreign Bank and Financial Accounts requirements mandated by the Foreign Account Tax Compliance Act (FATCA). Also, the availability of reinsurance is two to three times lower for offshore policies than domestic PPLI policies, so an individual that wants a higher life insurance death benefit would have a greater chance of successfully negotiating a policy in the U.S. (Nowotny, 2012).

According to Wells (2009), the benefits of offshore policies are minimal and should only be considered under limited circumstances as they are cumbersome to initiate because the underwriting and physical examination processes must be completed offshore as well. In an offshore arrangement, oftentimes, the policyholder will opt to use a trust located in the offshore location to act as the legal owner of the product. This provides administrative convenience for the policyholder and can be useful for estate and financial planning purposes (Blazzard & Stone, 1999). However, there is a rising domestic advantage for PPLI contracts, as most U.S. investors feel more comfortable with an insurance company that is subject to U.S. law and regulations. Furthermore, with states like Alaska and South Dakota having extremely low premium taxes and allowing for dynasty trusts (no rule against perpetuity), the costs and complexity of structuring a PPLI contract offshore is less appealing than in the past (Lowry, 2005).

Trusts and Jurisdictional Limitations

To understand the benefits of comprehensive planning, it is important to understand the basic elements of a trust. Essentially, the three parties of a trust are 1) the settlor or grantor, 2) the trustee, and 3) the beneficiary(ies). A settlor transfers property to a trustee, who then holds title to that property in trust for the benefit of the named beneficiary. Trustees have a fiduciary duty to manage the trust to the benefit of the equitable owners or beneficiaries. A fiduciary duty implies the highest standard of care in equity or law.

In 1983, South Dakota was the first state to implement unlimited duration dynasty trust statutes, which essentially allows a trust to run into perpetuity. This was in response to the case of *Estate of Murphy vs. Commissioner* (1990) and put in motion a series of favorable trust provisions that make South Dakota a bellwether of modern trust concepts. Since that time, both Alaska and Delaware have passed similar legislation, allowing families to hold assets in trust and to make well-defined distributions to beneficiaries at each generation. Because the assets stay in the trust, they are not subject to estate, gift, or goods and services (GST) taxes. King and McDowell (2017) expounded on the beneficial trust laws of South Dakota that are intentionally favorable for PPLI with private equity or alternative assets as the underlying investment. The lower premium taxes and favorable trust laws result in much larger life insurance contracts being issued onshore in South Dakota versus the traditional route offshore. King and McDowell (2017) explained how a South Dakota LLC can be utilized with a resident co-managing LLC member in South Dakota to purchase a PPLI policy within the LLC and thereby benefit from the lower premium tax (meanwhile the LLC owners can be out of state trusts or individuals).

According to King and McDowell (2017), South Dakota is a unique jurisdiction as its statutes also allow for in-kind distributions of PPLI cash value during lifetime as well as PPLI death benefits. These provisions create an opportunity for private equity and other alternative assets, which are typically illiquid, to be utilized within the PPLI structure. Further, South Dakota is unique in that in-kind premiums may be allowed if the insurance carrier and the South Dakota Division of Insurance approve. However, there may be negative tax consequences if appreciated property is contributed as premium, which is more common offshore. The main emphasis is on the in-kind distributions, which allows the insurance carrier the opportunity to provide an orderly liquidation, sale, or transfer of private equity assets to the PPLI beneficiaries.

In 1997, Alaska followed South Dakota's example and effectively eliminated its Rule Against Perpetuities regarding beneficial interests held in trust, opening the door for dynasty trusts. Greer (2001) highlighted both the asset protection and tax benefits of the dynasty trust:

> A dynasty trust is an irrevocable trust intended to benefit successive generations of beneficiaries. The settlor of a dynasty trust usually has two objectives. The first objective is to protect the assets for the longest possible period of time from the eroding effect of federal transfer taxes while making the assets available for future generations. These transfer taxes are the federal gift tax, the estate tax and the generation-skipping tax. The second objective is to protect the trust assets from claims that may be brought by a beneficiary's creditors. To accomplish both objectives, the assets must be permitted to continue in trust. (p. 255)

Turnier and Harrison (2009) affirmed the value of the dynasty trust as a device for minimizing the weight of transfer taxes within wealthy families. However, they were clear to point out that inflation and a growing population of living descendants can sometimes outstrip the ability of such a trust to provide for descendants in the style to which they are likely to have become accustomed. Madoff (2010) raised concerns about the perpetuity of trusts and explained how the Hershey Trust Company's assets had grown to over $8 billion and it was virtually impossible for the trustees to spend all the trust income on the Milton Hershey School. Madoff (2010) noted that "Even after spending ninety three thousand dollars a year to educate, house, clothe, feed, and nurture each of its twelve hundred students, the school still had a reserve fund of more than $850 million from all the money it could not spend over the years" (p. 100). Milton Hershey founded the private tuition-free boarding school for orphan children in 1909, but the original trust language appears to have been too restrictive in comparison to the growth of the assets.

Tax Environment, Tax Deferral of Investments, Tax-Free Income Stream, Tax-Free Benefit

With the U.S. national debt at an all-time high, and debt ceiling adjustments causing political friction, the case for PPLI has never been stronger. Although no one can predict what Congress will do at any point, it is quite likely we will see higher income tax rates soon, along with an increase in federal estate tax rates and a decrease in available income tax deductions. For HNW investors, PPLI contracts could be the solution to tax planning in an unfriendly tax environment (Nowotny, 2012). The sweeping tax reform of the 2017 Tax Cut and Jobs Act (TCJA) limited state and local tax deduction to a combined $10,000 for income, sales, and property taxes. For states with a high income tax, such as New York or California, the limited deduction had a harsh tax impact on high-income earners in those jurisdictions. On the other hand, the TCJA doubled the standard deductions and raised the estate tax exemption; this created a unique and beneficial environment for HNW clients to explore PPLI as a planning solution. The Secure Act of 2020 reduced the stretch IRA benefits and accelerated the taxation of inherited IRAs, thus making traditional retirement and estate planning more difficult for the HNW (DiLellio & Kinsmen, 2020).

Accredited investors are often direct owners of real estate and businesses. As such they are no strangers to paying either directly or indirectly a significant amount of local, state, and federal tax. The headwind of this tax burden can make it difficult for a HNW individual to accumulate wealth. Namely, a HNW individual will be contributing to the tax base through federal personal income tax, state personal income tax, federal corporate income tax, state corporate income tax, sales tax, business and occupancy tax, payroll tax, workers compensation collections, licensing fees, capital gains tax, state death tax, and federal estate tax. Proper tax planning takes all these factors into consideration when developing an integrated financial plan with wealth managers.

According to Wells (2009),

> ...the (PPLI) policy framework allows for the tax-free accumulation of wealth. This is especially important with the current economic environment within the U.S. as we face a seemingly insurmountable federal deficit and the probability of higher tax levels in the future. PPLI provides a great opportunity to invest in alpha generating, but tax-inefficient, investment vehicles in a tax-free environment. That tax savings can be substantial when compounded over the life of the policy. (p. 111)

The academic literature has been consistent from the beginning to communicate the tax benefits of a PPLI policy. Cohen et al. (1999) cleverly said,

> While many investors believe there is little that can be done about 'death and taxes,' private placement variable life insurance has the potential of eliminating income tax on hedge fund and other earnings and, with proper estate planning, estate tax as

> well...Properly created and administered, PPVL insurance achieves income tax-free investing - none of the 'inside buildup' is subject to current income tax, and if the policy is maintained until the death of the insured, the entire death benefit (including all the earnings from the hedge fund or managed accounts) will be received by the beneficiary free of all income tax...The higher the assumed tax rate and investment return, the greater the projected tax benefits of the insurance product. (p. 27)

Blazzard and Stone (1999) noted that policyholders of a PPLI contract enjoy the benefits of tax deferral during their lifetime and investment gains are passed on to the beneficiary totally income-tax free. Manzke (1999) was clear to point out the tax differences between modified endowment contracts (MECs) and non-modified endowment contracts (non-MECs). If the PPLI policy was structured as a non-MEC, the policyholder could take their investment basis plus 'loans' out of the policy in an income tax-free manner, providing greater flexibility for the policy holder to use these assets.

Brunel (2001) discussed the important advantages of asset location in the wealth management process and was clear that a variable life insurance policy is a good vehicle to shelter assets from current income and capital gains taxes.

Padgett (2009) wrote about how life insurance has received preferential treatment under the Internal Revenue Code. Padgett (2009) wrote that income taxation of the investment gains inside a properly structured PPLI policy are at least deferred and, at best, eliminated. Padgett (2009) also observed that the PPLI policy avoids the increasing complexity of K-1s. This was a significant contribution to the literature because it highlights not only the financial savings of tax-deferral/elimination, but also the much lighter accounting burden to the individual. Padgett (2009) also highlighted the importance of holding the policy long term to escape all income tax at death. While this may sound like a difficult commitment for an individual to make, it is the foundation of life insurance and a major reason for the preferential tax treatment. Furthermore, cash value life insurance policies can generally be transferred via 1035 exchanges to different policies with different insurance companies on different contractual terms, which can create additional optionality for the policyholder and maintain control over the PPLI arrangement. If an insurance carrier began imposing unfavorable mortality and expense charges, the policyholder may be able to exchange the policy for a similar policy from a different carrier.

Nowotny (2012) made clear that the legislative intent behind the tax advantages of life insurance was rooted in social policy designed to encourage household savings and insurance protection (protecting orphans and widows). There are five distinct tax advantages of life insurance: 1) tax-deferral of investment gains, 2) non-recognition of capital gains, 3) the option of tax-free access to policy cash values through a partial surrender of the cash value and low-cost policy loans, 4) income-tax-free death benefit which would include investment gains, and 5) estate-tax-free death benefits through the use of third-party ownership of the policy.

The life insurance industry benefits from a well-organized and active advocacy group in Washington D.C., The American Council of Life Insurers (ACLI), which advocates on behalf of 280 member companies dedicated to providing products and services that promote consumers' financial and retirement security. ACLI represents member companies in state, federal, and international forums for public policy that supports the industry marketplace and the families that rely on life insurers' products. ACLI members represent 95% of industry assets in the US. Other active advocacy groups include The Federal Policy Group and The American Council of Life Insurers. Together these advocacy groups have fiercely guarded the historical tax benefits in the Internal Revenue Code from being eroded or modified by lawmakers. Given such a strong voice in Washington D.C., it was no surprise that advocacy groups were able to include revisions to the Internal Revenue Code Section 7702 in the recent Consolidated Appropriations Act of 2021 signed into law on December 27th, 2020. Inside this 5,593-page bill were some considerable changes that determine how much premium is allowed in each life insurance policy before a policy is considered a MEC and taxed differently. Specifically, the insurance carriers were pushing for a lower 7702 interest rate assumption to sustain their operations going forward in an extraordinarily low interest rate environment offering guaranteed products. Further, the new legislation allows for larger premiums with lower death benefits, thereby enhancing the structure of an accumulation-based insurance product on a tax-favored basis. This was the first piece of legislation pertaining to 7702 limits since the 1980's and may be interpreted by some as the regulatory bodies approving the structure and even making it more beneficial for the consumer.

Modified and Non-Modified Endowment Contracts

In understanding the architecture of a PPLI contract, it is paramount to understand the difference between MECs and non-MECs. This is remarkably significant for policyholders to understand because it makes the difference on whether they can access the policy cash values through a partial surrender of principal and low-cost policy loans on a tax-free basis. This is determined through actuarial calculations quantifying the difference between the amount of premium paid and the death benefit provided by the policy. If the PPLI contract is deemed to be a non-MEC, as defined by the parameters of the IRC, then policy loans and partial surrenders can be exempt from income tax. If the PPLI contract is deemed to be a MEC, the lifetime tax benefits to access the cash value is relinquished. For U.S. non-residents, these rules do not apply, and it is not necessary for an offshore policy of a non-resident to be U.S. tax compliant.

To better understand a MEC, it is worth reviewing endowments. An endowment is generally considered to be a financial arrangement whereby the income of an underlying asset is used to provide for the continuing support or maintenance of an institution or a charitable effort. Endowments are commonly organized as a trust, a private foundation, or a public charity. Some examples of endowments that are noteworthy are the Harvard ($53 billion), Yale ($31 billion), Stanford ($29 billion), and Princeton ($26 billion) university endowments. As not-for-profits, foundations and charities benefit from favorable tax treatment on their underlying investment portfolios while the assets remain inside the endowment. There is no taxation of revenues or profits within the organization, but income derived from these organizations in the form of wages are taxed as ordinary income. On a smaller scale, if an affluent family has created a family foundation, the assets remain sheltered from taxation within the foundation, and the only viable mechanism to recapture funds from the foundation back to the family is through gainful employment within the foundation to administratively support the charitable cause. These employment arrangements are synonymous with common employment arrangements and all income derived is taxed as ordinary income. A MEC works remarkably similar.

In 1982, Congress enacted a series of income tax laws with the purpose of establishing a statutory definition of life insurance set forth in Code Section 7702. Congress was concerned that universal life policies would be utilized for single-premium, short-term, tax-deferred cash accumulation vehicles (Manzke, 1999). The rules are complicated and revolve around whether the policy qualifies as a non-MEC or a MEC. If a policy is deemed to be a non-MEC, then it would be considered life insurance and entitled to income tax benefits. A MEC is a policy whose funding has exceeded the prescribed federal tax law limits. It is important to note that life insurance policies entered into before June 20th, 1988 are not considered MECs, as the lawmakers set a precedent of grandfathering provisions on existing policies. If a policy has morphed into a MEC by exceeding premium limits, then the taxation of withdrawals from the policy becomes similar to a non-qualified annuity. Any withdrawals from a non-qualified annuity are taxed as ordinary income, while any investments remaining invested inside the annuity grow sheltered from tax (much like a foundation). However, the death benefit from a MEC policy is still income tax-free, whereas a non-qualified annuity would incur an ordinary income tax on the gains (which is why the non-qualified annuity is a good tool to grow assets in a tax-favored manner to gift to a charity at death to avoid all taxes).

If a PPLI policy is funded by at least seven statutorily defined level annual premiums, it will meet the statutory definition of life insurance and will be considered a non-MEC (Manzke, 1999). The limitations (passed in December 2020) significantly shorten the funding period required and make the newer policies more favorable to the consumer. The new funding schedule will be applied to the analytical model discussed later. If a PPLI policy converts to a MEC, it cannot be changed back. Therefore, it is important to maintain the corridor between the cash value and the death benefit within the PPLI policy so that it does not morph into a MEC (Wells, 2009). Oftentimes, the role of the insurance professional is to monitor the policy for maintenance of cash value/death benefit ratios to maintain the appropriate corridor between the cash value and death benefit, maintaining the advantageous tax treatment of the policy in accordance with Federal guidelines. The corridor is the difference between a policy's death benefit and its cash value. A life insurance policy must have a sufficient amount at risk to meet the IRS definition of insurance and qualify for the favorable tax treatment of withdrawals and policy loans. This corridor is remarkably small as the policy ages, but it is important to understand. Further, with a maximum funded PPLI non-MEC arrangement, unlike a retail life insurance policy, it can still work well on an insured in their 50's, 60's, or even 70's. Table 1 showcases the taxability of insurance contract benefits.

Table 1

Taxability of Insurance Contract Benefits

	MEC	Non-MEC	Qualified Annuity
Withdrawals	Taxable	Tax Free	Taxable
Loans	Taxable	Tax Free	N/A
Death Benefit	Tax Free	Tax Free	Taxable

Diversification and Investor Control

Cole and Kailus (2002) explained different types of life insurance products and highlighted the regulatory context for PPLI. The IRS regulates the tax treatment of life insurance, and because a PPLI contract is a private placement, the SEC does not have jurisdiction over the contract. Under section 817(h) of the Internal Revenue Code, the underlying cash value investments must be diversified in that no more than 55% of the value of the total assets of the account can be placed with any one investment, 70% with any two investments, 80% with any three investments, and 90% with any four investments (Cole & Kailus, 2002). Furthermore, in a PPLI contract, for the contract to be considered life insurance, the policyholder should not have the ability to influence the investment decisions of the manager. In the PPLI arrangement, the investment managers technically work for the insurance carrier to provide a complete package to the policyholder. Once a policy is in force, the policyholder can select from various investment options provided by the insurance company, but they are prohibited from hiring or firing the investment advisor or sub-advisor to an insurance dedicated fund. The policyholder retains the right to transfer the policy via 1035 exchange to a different insurance company with different underlying investment options.

Planned Giving Tools & Techniques

According to Brown (2004), donors with great wealth share the same basic motivations with all donors but have a greater need for tax and planning information. Aside from outright bequests to a family foundation, publicly supported charity, or a donor advised fund (DAF), there are a handful of planned giving techniques that planned giving professionals often utilize. In reviewing the literature of planned giving, most of the discussion around the tools are related to 1) charitable lead trusts, 2) charitable remainder trusts, and 3) charitable gift annuities.

Charitable lead trusts are often constructed as a gift to an irrevocable trust designed to provide financial support to one or more charities for years. A named charity receives an income stream for a period of time and the future interest irrevocably benefits one or more individual heirs. Some families may opt to set up a charitable lead trust for an income tax deduction for charitable donations and savings on estate and gift taxes. Charitable lead trusts can accelerate an inheritance when funded during the donor's lifetime (Morrow, 1997).

Charitable remainder trusts (CRT) are nearly the exact opposite of a charitable lead trust. These arrangements allow a family to convert a highly appreciated asset (e.g., equity or real estate) into lifetime income. A charitable remainder trust is a tax-exempt irrevocable trust designed to reduce the taxable income of a family and provide a remainder benefit to a charity in the future. The donor receives an income stream from the trust for a term of years or life and the named charity receives the remaining trust assets at the end of the trust term. When the trust is funded, the donor receives an immediate income tax deduction based on the present value of the assets that will eventually go to the named charity. The National Committee on Planned Giving conducted a survey of donors in 2000 and found that, in strong contrast to bequest giving, most donors to CRTs first learned about the structure from legal or financial advisors (NCPG, 2001).

The survey also revealed that CRT donors have higher median incomes and are more likely to be concerned with taxes and planning issues.

Like a charitable remainder trust, a charitable gift annuity involves a donor making a sizeable gift to a charity and in return receives a partial tax deduction for the donated amount and a fixed stream of income for life. Many large nonprofit organizations and universities offer charitable gift annuities.

Life insurance can be utilized as a planned giving tool as well. Generally, it takes one of two forms: a policyholder will list a charity as a named beneficiary of the death benefit, or a family will donate a policy with cash value to a charity. If a policyholder wants to list a charity as a beneficiary, it usually only takes the submission of a one-page form to the insurance carrier. Life insurance payable to a charity involves none of the cost, delay, or uncertainty of probate. This arrangement may be less desirable to the planned giving professionals of the charity, as the policyholder could change their mind and modify their beneficiary in the future (vs. the charity owning the policy on the life of the donor). However, arranged properly, there is no slippage due to federal estate or state death taxes, state or federal income taxes, administration or estate settlement costs, or any other fees or charges (Leimberg & Zipse, 2006). This arrangement keeps the maximum control in the policyholder's hands because they can update the beneficiary allocation at any time. Collins (1996) stated that the most effective plan of wealth transfer combines asset protection and gifting techniques that employ some form of leverage. Collins (1996) further described the GST-exempt life insurance trust, sometimes called a dynasty trust, as the most effective asset protection and gift leveraging technique. Collins (1996) cited this was due to the velocity from premiums to proceeds and that the benefit can last for generations.

If a family desires to donate a cash value policy to a charity, it is most beneficial for the charity to receive a single-premium or paid-up (or soon to be paid-up) policy. Charities are not in the business of retaining life insurance policies on their donors, and it can be confusing to the staff of an inexperienced charity to continue using cash flow to pay for future premiums on a life insurance policy on one of their donors. Quite the contrary, most nonprofits want their major donor constituency to enjoy long lives and keep making annual gifts. In the end, life insurance under either scenario can provide an amplified gift to charities. Incredible leverage is possible because a relatively small amount of premiums can translate into a large and meaningful tax advantaged gift. The Reverse Endowment Model, discussed in Chapter 5, utilizes the first option of a policyholder listing a charity as a named beneficiary of the death benefit within a planned giving context.

Gaps in the Literature and Research

Generally practitioners have contributed to the research on PPLI, which has provided limited knowledge about the parameters of the construct for the HNW business family. The literature seems targeted to UHNW family offices and UHNW advisors, and there is a gap in addressing the supply side of the arrangement or where it might intersect with demand in different demographics and markets. From a practitioner's perspective, PPLI seems to be a growing phenomenon at the individual level among single family offices and UHNW. Although professionals have been publishing academic articles for 20 years on the topic, recent technological improvements allowing for smaller minimums into alternative investments, along with growing deficits and debts at the federal level, is creating an environment that is ideal for the PPLI arrangements among the HNW population. A properly structured PPLI contract can carry the allegorical cargo of a family's wealth through the uncertain seas of the future tax environments. However, there are still some significant gaps in the academic literature that will benefit practitioners by adding clear knowledge in the theory, practice, and application of PPLI.

- There appears to be a lack of discussion around single family, multi-family, and professional family offices and their utilization of PPLI.
- There appears to be a lack of discussion around single family offices and their utilization of dynasty trusts and family bank constructs.
- There appears to be a lack of discussion around the vast differences in state premium tax levels and insurance regulations on in-kind distributions.
- There appears to be a lack of discussion about how Private Placement Variable Annuities are utilized in charitable planning for UHNW families.
- There appears to be a lack of discussion around the ease of changing beneficiaries on a PPLI policy between a family foundation, donor advised funds, non-profit organizations, family bank, or named individuals.
- There appears to be a lack of discussion about living benefits on permanent life insurance policies that pay benefits for chronic, critical, or terminal illness. It is now common for insurance carriers to include living benefits on permanent life insurance policies to cover long-term care needs. Will these benefits be negotiated into a PPLI policy in the future?
- From a quantitative perspective, can you achieve a higher leveraged asset transfer with a guaranteed universal life (GUL) policy or with an accumulation focused PPLI policy per premium dollar? How much impact do the new 7702 regulations have on the calculation? Is it more efficient to utilize a split-dollar arrangement in ILIT planning with a GUL contract or a PPLI contract?

- There appears to be a lack of discussion and quantitative analysis around optimal drawdown strategies in retirement for HNW utilizing PPLI, versus limitations of Roth IRAs, Roth 401(k)s, and Roth 403(b)s.

CHAPTER 3: RESEARCH DESIGN AND METHODS

Overview

The purpose of this section is to introduce the mixed method design for this study to determine why the PPLI strategy seems underutilized by HNW and UHNW individuals and to understand the best practices to achieve maximum tax alpha for different policyholder groups (UHNW, HNW, and foreign UHNW). This approach will allow me to understand the qualitative landscape of practitioners and industry leaders to fill voids in the literature by addressing gaps in published knowledge regarding PPLI. It also ensures the proper design for a quantitative analysis of measuring tax alpha across the various demographics. The research plan, including the methodology, motivation, study participants, data collection, data analysis, trustworthiness, and ethical concerns, will all be addressed.

Research Design and Approach

A convergent mixed method design was chosen as it will help practitioners, product structurers, asset managers, and policyholders best understand both the qualitative and quantitative phenomena of PPLI. The research strategy deployed first involves a phase of qualitative data collection and analysis, followed by a second phase of quantitative data collection and analysis that builds on the results of the first phase. The purpose of the strategy is to utilize quantitative data and results to help interpret the initial qualitative findings (Creswell, 2009). Due to the nascent academic knowledge base of PPLI, a sequential exploratory strategy was best suited to explore the phenomenon at hand and can be used to help generalize qualitative findings to different samples of chosen populations. This is a common approach for researchers to utilize in creating the proper instrument, where current instruments are not available or inadequate. In the case of PPLI, the instrument to be developed is a measurement of tax alpha across different simulated case studies. The three-phase approach of the study included: gathering qualitative data and analyzing it, using the analysis to develop the proper analytical model to measure tax alpha, and applying the instrument to a sample population (Creswell & Plano Clark, 2007). The methodology was a suitable fit for this study as it allowed me to both explore phenomena as well as expand the qualitative findings and academic knowledge base.

Study Population and Sampling for Professional Interviews

The sample was drawn from a population of professionals that have experience working with PPLI in various contexts including, but not limited to, estate & tax attorneys, private banking & trust officers, alternative asset managers, lobbyists & policy advocates, insurance companies, insurance dedicated funds (IDF), separately managed account (SMA) administrators, and experienced insurance advisors. This synoptic perspective on PPLI buttressed the sequential exploratory strategy and set the groundwork for developing an analysis to measure the tax alpha across different simulated case studies. I conducted 27 professional interviews with thought and industry leaders for this phase of the research. This sample was meaningful in assessing the capacity of professionals to engage with HNW investors interested in PPLI and its multi-generational tax advantages.

Study Population and Sampling for Surveys

The sample was drawn from a population of accredited investors and business families to uncover knowledge levels in the areas of PPLI, DAFs, family foundations, qualified retirement plans, commercial real estate, dynasty trusts, private equity, irrevocable life insurance (ILIT) trusts, and family bank structures. I collected 59 surveys with accredited investors and business families to gauge their interest and possible demand for PPLI.

Data Collection Methods and Instruments

The format of the interviews was virtual. Specifically, I used Zoom and supporting platforms that allowed recording and archiving of interviews. I then used a professional dictation service for each video interview. Once the interviews were transcribed, they were imported into NVivo, a computer assisted qualitative data analysis software. I used the software to query keywords for comparison with manually coded categories and themes. The interviews, as the first phase of the sequential exploratory strategy, informed the development of an analytical model to measure the tax alpha across different simulated case studies.

I also conducted an integrative survey methods project to identify areas of knowledge that might be underdeveloped for business families and gauge demand for PPLI. UHNW business families typically deploy a family office arrangement whereby professional advisors are collaborating across tax, wealth, and estate planning. Although nearly all business families can benefit from coordinated planning, my hypothesis is that many business families are not receiving the caliber of professional advice that is commonplace in the UHNW demographic. There is good news, however, in that the world is increasingly connected. Through online educational videos, business families at large can begin to understand the advanced planning concepts that reside within family offices to better protect and grow their family wealth.

I conducted a survey of accredited investors and business families that included questions regarding what discussion topics would be most interesting for them to learn about. Most business owners rely on their professional advisors to educate them about advanced business and wealth structuring topics. The goal of the survey research was to identify areas of knowledge that are underdeveloped for business families and gauge demand for PPLI.

The survey instrument began with a personal characteristics section to identify if the respondent was a member of a UHNW family, a qualified purchaser, an accredited investor, or regular investor. This was defined in the instrument and helped to clarify and segment the responses to different categories of respondents. Next, the survey asked if they were a business owner as represented by at least 5% ownership in a business. The next set of questions (i.e., if they own a home, if they own investment real estate, if they have children or grandchildren) identified further personal characteristics for market segmentation and analysis.

Consistent with the notion that entrepreneurs can be some of the most generous actors in society, I included a question related to family foundations and DAFs, although I did not include a question about planned giving investing, which has become a popular methodology for foundation investments.

Most survey questions pertained to trust and estate planning concepts that are often employed by the UHNW. After these questions followed a series of family business questions covering topics such as qualified plans, alternative investments, and cash value life insurance. A key question embedded here was an inquiry of their opinion on how the US will be able to rectify the national debt. Essentially, the two most common sense solutions were to reduce government expenditures or increase taxes in the future. This question was not meant to insult the respondent, but rather to get an idea of how they think the future tax code will look.

Due to the high concentration of respondents inside the state of Washington, I considered adding a question for Washington residents regarding their $2.1M exemption amount on the state death tax. This is important because many HNW will be impacted by this seemingly invisible tax. In practice, most business families are focused on the federal estate tax and often do not consider the impact of state death taxes. In Washington, this tax is quite repressive and it seems illogical that it does not match the federal level. There have been initiatives to increase the exemption amount, but from my personal interactions with lawmakers in Olympia the political sentiment is to keep the estate tax as is. In the end, I decided not to add the question as I wanted a parsimonious explanation of results that would apply to all survey respondents.

The final question asked how interesting it would be for them to have a tax advisor calculate and explain how to cover the potential federal estate tax and state estate tax obligations on illiquid family assets such as businesses or real estate, or identify means to minimize income tax liabilities through planning and asset location techniques. This data will be significant to analyze and look for trends among different groupings and cross-sections, particularly between HNW and UHNW respondents.

The data collected will be used to clarify educational opportunities that are relevant and meaningful. The data will be kept confidential but will be utilized to follow up with respondents by providing them complimentary access to online educational videos within a "Virtual Business Family Institute" digital library once the content has been curated. This was mentioned at the end of the cover letter to incentivize participation in the study.

Measures or Operationalization

Beginning in September 2020, I began reaching out to existing professional networks to identify the best professional candidates to interview at highly respected firms. Particular care was given to make sure that the person that I interviewed would be uniquely qualified based on their level of experience working with PPLI. Once I received approval from the Institutional Review Board, I contacted over 20 professionals to obtain their consent to collect data in the form of a two hour interview. I obtained their consent for future use of the data for educational and professional purposes. The interviews spanned from September 2020 to March 2021. Each interview took place in a single interview session.

Trustworthiness

Trustworthiness is critical to effective and empirical research. The ingredients of trustworthiness are made up from credibility, transferability, dependability, and confirmability (Guba & Lincoln, 2005). Confirmability can be further enhanced by the elimination of researcher bias. In this context, the various case studies were approached from the perspective of a fiduciary advisor. The fiduciary duty, by nature, is intended to eliminate conflicts of interest. A fiduciary duty is the highest standard of care, and it entails always acting in the beneficiary's best interest, even if doing so is contrary to yours. The most common example of a fiduciary is a trustee of a trust. Constant comparative analysis was critical to assess the theories that emerge from the data. Furthermore, transcribing and storing interviews and coding them ensured a thorough understanding and reference point to refer to by third parties.

Ethical Concerns

The risks to human subjects during this study were minimal. The informed consent form was sent to each participant prior to the interview. The validity and reliability of the study was ensured by following the methods outlined above.

CHAPTER 4: DATA ANALYSIS AND FINDINGS

Survey Data - Market Demand

With more than 27 million privately held businesses in the US, business owners make up much of the economic fabric of the country and can have tremendous planned giving. Entrepreneurship and philanthropy can be woven together in a cycle of wealth creation and planned giving. Consider Andrew Carnegie, who led the expansion of the American steel industry in the late 19th century, who in the last 18 years of his life distributed almost 90% of his fortune to charities, foundations, and universities. He penned a short article in 1889 which stimulated a wave of philanthropy by calling on the rich to use their surplus wealth for planned giving. According to Fidelity Charitable (2018), entrepreneurs give and volunteer more than peers of similar economic circumstances. In fact, on average, the median annual gift for entrepreneurs is 50% higher than non-entrepreneurs.

As a practitioner working with business families, I have come to realize that many who are not UHNW do not understand the array of alternative investment options available to them. Family offices of the ultra-wealthy regularly invest in alternative assets that are less correlated to the public equity markets. Upper-quartile alternative asset managers, such as KKR and Blackstone, have historically managed assets for the largest pensions, endowments, and sovereign wealth funds. The Yale endowment has a reputation as one of the best-performing investment portfolios in American higher education. The endowment has become known for seeking out alternative investment opportunities, rather than traditional stocks, bonds, and cash. Alternative investments typically include private equity, real estate, private credit, energy, and hedge funds. Technology has allowed for much smaller minimums and increased liquidity for interested investors in alternative assets. Furthermore, access points have been created through various registered investment advisory firms to the elite alternative asset managers in NYC, London, Hong Kong, and Singapore.

Although most business families are not UHNW, they can still benefit from elite talent in asset management by utilizing alternative asset managers if they qualify as an accredited investor. I consider it an important step for business families to understand and explore the opportunities available in the alternative asset space in addition to the traditional investment arena, especially if they are interested in learning more about how the ultra-wealthy family offices structure their investment portfolios.

The focus of the integrated survey research was to identify the actual market demand for PPLI and dynasty trusts among business families and the HNW demographic. The goal was to obtain at least 50 surveys from individuals or families that would be recognized by the SEC as accredited investors. I was able to conduct 57 surveys. The purpose of surveying more than 50 families that qualify as accredited investors was to provide a depth of insight into the potential opportunities associated with PPLI among the HNW demographic and identify if there is a market disconnect between the supply and demand related to the PPLI phenomena. This was accomplished by surveying the target group to identify the current level of knowledge around advanced planning structures and to inquire about the interest level of receiving more professional guidance.

Survey Data - Observations and Findings

During the survey, I wanted to inquire among the survey participants who owned a business, who owned a home, and who owned an investment property. I thought this would be important demographic information to define the target market. Of the 57 surveys collected, 44 respondents owned a business, 53 owned a home, and 38 owned an investment property or second home. Further, I wanted to inquire about the family composition of the respondents by inquiring whether they had any children or grandchildren, to which 52 of the 57 respondents replied that they did. In conclusion, most of the survey respondents include business owners that also own investment and residential real estate and likely had family heirs.

From a wealth level perspective, I thought it would be important to segment the respondents into different categories: those who did not meet accredited investor status (n = 4) and those who did (n = 51). This allowed me to filter out the four respondents who would not qualify under the SEC guidelines to participate in a private placement arrangement. Interestingly, 21 respondents acknowledged that their balance sheet far exceeded the SEC guideline, as they had more than $5M of net worth.

In August 2020, the SEC slightly expanded the accredited investor definition. The amendments opened the status to certain professional certifications, designations, or credentials (including series 65); knowledgeable employees of private funds; LLC's, First Nation Tribes, and family offices that have at least $5mm in assets; and finally spousal equivalents of accredited investors to pool funds. This reflects a growing demand for alternative investment opportunities.

The survey was designed to uncover the knowledge level associated with many key ingredients utilized by the UHNW in their planning arrangements. The survey can be found in Appendix B while the results of the survey (i.e., frequencies) can be found in Appendix C.

Looking over the results, PPLI and the income tax and investment benefits of cash value life insurance were not well understood. Building upon the complexity, the knowledge and experience around ILITs fell off further and family foundations and DAFs were understood even less. Finally, the least understood structure of the survey was the Dynasty Trust and/or the 'Family Bank.'

The attitudinal responses revealed that participants were most knowledgeable about real estate. This is not surprising, as home ownership is often a first step to building family wealth. Next, respondents were most familiar with corporate qualified retirement plans. Since most of the respondents own a business, it was apparent that they have almost a moderate level of knowledge pertaining to the structures. Owning a business is certainly a pathway to creating wealth, although most businesses never survive the start-up phase. The third most knowledgeable area centered on private equity and alternative investments. Again, this was no surprise as most of the respondents already owned a business and understood the growth potential of private equity and the inflation protection provided by real assets.

From a practitioner perspective, results were informative and confirming of what is experienced in conversations with business families. The majority of the respondents (43-14) represented main street small business owners as could be seen by Q1: Do you own a business?

Five respondents qualified as accredited investors by means of their income. That said, just because an individual qualifies for accredited investor status based on their net worth (often through inheritance) it does not mean that they also understand the sophisticated asset and tax structuring that are more commonplace among the UHNW family offices. However, many do understand the beneficial elements of real estate, which makes it one of the best places to train children for the responsibilities of wealth. Respondents were a prime demographic for cross-generational planning with a long-term vision, as most had children or grandchildren.

From an economic (i.e., supply/demand) perspective, there seems to be a demand for this level of planning even among the HNW demographic that has not yet been brought to equilibrium from the supply curve. This hypothesis is substantiated from the survey in two ways. Q14 inquired about the level of interest in advanced planning. Over 90% of respondents indicated moderate to extreme interest in advanced planning, which supports the notion of demand for PPLI and supporting structures. Q13 focused on the macro environment of tax policy by asking if the respondent thought the U.S. Federal debt would be reduced in the future by reducing government expenditures or increasing taxes to cover the annual federal deficit and begin reducing debt obligations. 75% of respondents felt that taxes would be increasing in the future, thereby further buttressing the interest or demand for more sophisticated planning.

From a practitioner perspective, I did not expect the underground demand for sophisticated structures and professional planning to be so strong. However, I can understand why, especially given the backdrop of the current monetary and fiscal policy, the current state of the federal balance sheet, and the belief that tax efficiencies can be beneficial to families who are thoughtful in their planning.

Interview Data - Supply Side

If the survey represented the demand side of the economic model related to PPLI, the professional interviews represented the supply side. It was important to have a clear understanding of the proper application of PPLI among the HNW demographic. To obtain as much detailed information as possible while shielding the interviewee from public scrutiny, I have left the specific names and firms anonymous.

As of 2021, the minimum investment into a PPLI arrangement is $3M USD. This is more a business efficiency decision by most professionals in the space, as the average placement far exceeds that amount. However, this puts the arrangement within reach of the HNW, particularly after a liquidity event such as selling a business or a music catalog. Most of the HNW would fall into the $1M-$5M wealth tier, making it difficult to properly allocate to a PPLI arrangement. For the HNW family that is selling a business or experiencing a non-real estate liquidity event around $10M, the PPLI construct can be a remarkably productive cross-generational planning technique. For a detailed view of the HNW population data for 2018, please see White and Shaban (2019)

Interview Data - Observations and Findings

To understand the supply side of PPLI, I set out to interview 15 thought and industry leaders with experience or knowledge in the space. In the end, I conducted 27 professional interviews. The interviews were intriguing and insightful on how to best structure policies for US HNW, US UHNW, foreign UHNW. Participants went into great detail discussing the beneficial elements of the PPLI construct for the business family or the single-family office. Across the board, they continually reaffirmed the tax efficiency and asset protection of PPLI and the utility of the construct among UHNW. Discussing optimal insurance policy structuring was highly technical and provided insights and techniques that can easily be used by business families and helped inform the model discussed later in Chapter 5. Furthermore, the discussions around trust and entity structuring proved to be incredibly valuable in understanding how the UHNW, both foreign and domestic, typically structure their PPLI arrangements. This was particularly helpful, as there appears to be a growing demand from both Israeli and Chinese UHNW to utilize a PPLI arrangement in their cross-jurisdictional planning.

For the US UHNW, interviews revealed that the most common arrangement utilizing PPLI had to do with the family’s need for the funds during the grantor’s lifetime or not. If it is considered shelf money, or money that is not needing to be accessed prior to death, then the most common structure is a MEC for the purposes of more expedient cash value accumulation within the policy. If the family has a desire to access the funds in that respective generation, then a non-MEC policy is better for access via withdrawals to basis then loans. The policy is most typically owned directly by an LLC domiciled in South Dakota (or Alaska), with an LLC manager located within the jurisdiction. The LLC owner/member is most often a dynasty trust (or multiple dynasty trusts). The South Dakota jurisdiction is particularly beneficial for less liquid private equity investments as the statutes and regulations allow for an in-kind death benefit payment to the beneficiaries. However, this is less of a practical issue when utilizing evergreen private equity funds that have quarterly redemption windows.

The interviews confirmed the ideal way to access the policy cash value in a non-MEC was though policy loans without compromising the integrity of the death benefit. To provide secure lifetime access to the IDF investment account within the PPLI structure, a policy loan would be combined with a loan from the trust to the grantor (if the policy was owned by a trust).

The interviews revealed that for the foreign UHNW demographic, the jurisdiction of choice is typically Bermuda or the Cayman Islands. The policy is typically structured as a MEC, and the offshore jurisdictions allow for more flexibility on product options. Alternative policy structuring such as Frozen Cash Value (FCV), Limited Cash Value (LCV), or Zero Cash Value (ZCV) can be implemented aside from the standard US MEC or US non-MEC. The alternative policy structures allow for significantly higher premium contributions over a standard US MEC or non-MEC. Further, these alternative structures are also utilized for foreign policyholders looking to maintain product compliance within their home country as well. One highly experienced insurance professional said,

> If the individual has no ties here to the US, and they have gotten the money, let's say out of China, so they want to just reposition assets and get it into a US denominated policy. But they want something of a specialized private placement, it doesn't have to be the MEC or non-MEC. There are other structures of policies, things such as frozen cash value, or limited cash value. We would structure the policy in Bermuda or Cayman and that would typically be owned by a trust as well. If they're coming here to the US, you may do some inbound planning, by repositioning their assets prior to them arriving here in the US inside of a private placement life or a private placement annuity contract.

For the US HNW demographic, the most common structure is a non-MEC arrangement for tax-free access to the cash value during one's lifetime for income supplementation. It is most common for a HNW individual to construct the arrangement after a liquidity event, such as the sale of a family business (not necessarily real estate, as most families will utilize a 1031 exchange into another investment property). Due to the minimum premium commitment of $3M, it is understandable why the arrangement would normally occur on the heels of a business sale, as a privately owned business is a common asset among HNW and generally represents most of their overall net worth. The non-MEC policy is typically owned by an LLC or trust based in South Dakota (or Alaska). One interviewee said,

> You can have a trust itself be the owner of the policy, but as you mentioned, in a typical private placement life transaction, and if you're doing that here in the US, you're typically going to look to Delaware, South Dakota or Alaska. Those states have very low state premium taxes, which is the one thing in private placement, everything is unbundled, so you want to minimize fees. I have done transactions where the trust is established in, let's just say it's a New Jersey trust, but they want a private placement life policy. So we'll set up an LLC in South Dakota, because we'll get the better state premium taxes on an LLC in that state than we would in Delaware. There may be some reason the attorney wants to use a different state for the trust, and then the trust would have an LLC that it would own in one of those states to hold the policy. If the attorneys want to reposition the LLC within different trust structures, they can move membership or partnership interest. I've seen it done, as I mentioned, with the trust as a standalone owner, or even having a sub-entity such as an LLC, or a partnership.

The interviews were affirming that upper-quartile alternative asset managers are highly aware of the growing opportunity in the space and are working to bring this solution to COLI and BOLI marketplaces. These deferred compensation arrangements and corporate/bank owned life insurance arrangements are typically more than $100M, which represent institutional asset management opportunities for alternative asset managers such as KKR, Carlyle, Blackstone, etc. However, these asset managers need their strategies to be held inside an insurance dedicated fund (IDF) or an SMA, which has led KKR and Blackstone to recently create their own internal IDFs for the institutional investment arena. One highly reputable alternative asset manager said,

> Insurance companies definitely need higher yielding assets that from a risk adjusted perspective makes sense and this structure really helps it all come together. So I do think we're going to see growth here...I'm reading the series in terms of the five insurance companies we put in our product just last year alone. I think it's heading that direction.

Although these managers were keenly aware of HNW families investing in their alternative funds, there was little emphasis to directly penetrate the HNW market with an insurance dedicated fund to be utilized inside a PPLI arrangement, as they were better positioned to raise capital through an intermediary like iCapital through Registered Investment Advisory (RIA) firms. Furthermore, an insurance dedicated fund (IDF) investing in private equity would likely benefit from having diversification across multiple managers and vintages of private equity funds. This makes it difficult for a single manager to construct a diversified portfolio and highlights the need for a RIA to work with multiple managers in the construction of a diversified IDF for the HNW. In time, this may shift as alternative asset managers recognize the opportunities among the HNW and build corresponding IDFs that diversify internally across multiple investment strategies and vintages of funds.

Asking about noteworthy IDFs highlighted the tilt towards private credit. Golub is recognized as one of the most widely used asset managers in PPLI currently (Forbes Family Office, personal communication). Golub Capital is one of the largest non-bank middle market lenders and providers of senior debt and broadly syndicated loans with over $35 billion of capital under management. To understand why private credit would be utilized, one must understand the tax inefficiency of private credit. The interest income from the loans is taxed as ordinary income, thus benefiting from tax alpha inside the PPLI arrangement. At this point, from an individual perspective, the vast majority of PPLI policy holders are UHNW, who typically gravitate towards a capital preservation asset allocation model in their later years.

When inquiring about philanthropy, most interviewees could not think of a situation where PPLI had been used for philanthropic purposes. No participants were opposed to the idea, but many were quick to highlight the attributes of a similar arrangement called Private Placement Variable Annuities (PPVA). Much like a MEC, a PPVA allows assets to compound on a tax deferred basis. This structure pairs well with tax inefficient investments such as private credit or hedge funds and particularly for assets that are to be earmarked for philanthropy. At death, the gains would be taxed as ordinary income, which is currently the highest tax bucket, but if a 501(c)3 is a named beneficiary of the PPVA the funds would avoid probate and sidestep the income and estate tax. A PPVA is simpler to implement than a PPLI because there is no underwriting required and allows a family to grow capital earmarked for charity but not out of the family's reach if needed. Regarding foreign UHWN, one offshore insurance professional said, "For many non-residents, the annuity is a much better choice because you get the same deferral, same tax treatment. You don't have to go through underwriting and there's no limit on the amount you can put in."

The interview data suggested that the reason why PPLI seemed underutilized by HNW business families was due to a lack of knowledge or education on the construct. According to the professionals interviewed, most HNW clients and their advisors (i.e., attorneys, CPAs, investment advisors, life insurance specialists) do not know about PPLI. For investment brokers that work in a traditional wire house, they may be precluded from offering the PPLI policy by their broker/dealer (most likely because the margins are thin). Among experienced traditional life insurance professionals, even if they know about the arrangement, they may not choose to market the arrangement because of the higher compensation or commissions of retail life insurance products such as whole life. One experienced professional said,

> The education to the high net worth space. I mean, it really is, if you really look at the transaction, it's a great opportunity for someone. They can get into a wholesale base chassis structure, in this life insurance contract and the trade off to paying taxes is you are going to have some insurance and administrative fees in putting it together, they can have a customized investment to run the assets in the policy, if it's structured properly, they can take the funds out without paying taxes on those gains and upon them passing away, if it's done correctly, it's going to be estate tax free on any of those deferred gains, if they were accessed through loans go away as well from the income tax side and so I think a lot of it just really comes down to, a lot of it's the education, I think in that high net worth space. But when you tie this together with the right multi generational trust structure approach, it really can be... It's like a magical product.

Analytical Model Methods

I utilized the qualitative research results to conceptually shape the ideal policy and trust/entity structuring for a family that just experienced a liquidity event and had $3M to invest in a PPLI policy. I contacted life insurance professionals with PPLI experience working with Prudential and Zurich to obtain specially designed product illustrations directly from the carriers. The actuarial department within the insurance company prior to a life insurance contract prepared an illustration for the applicant that included the quantitative benefits to which the policyholder is entitled, the premiums required to maintain the benefits, the expenses related to the policy issue and maintenance, and the benefit and premium periods. An illustration was run from each insurance carrier for comparison. In the analysis, I assumed a 44-year-old female in excellent health. For illustrative purposes, I gave her a fictitious name of Kristina Kristoferson.

The life insurance illustration also included disclosure on the fees and expenses within the insurance contract. Primarily, these fees can be divided into two groups: one-time set-up fees and expenses/premium-based fees and ongoing policy servicing fees/asset-based fees. The one-time fees built into the illustration were the deferred acquisition charge which normally ranges from .007 to .01 and is intended to offset a federal tax on the insurance carrier, a structuring or consulting fee from the insurance professional (negotiable), and the state premium taxes. The only PPLI one-time expense not included in the illustration was the legal establishment of an LLC or trust domiciled in a jurisdiction of interest (approximately $5-$10K).

The life insurance illustration included the following expenses: a mortality and expense charge which is paid directly to the insurance carrier and represents part of the profit for the insurance carrier to place the contract, a consulting or servicing fee for the insurance professional, and the cost of insurance to cover the net amount at risk. Other costs associated with the policy would include ongoing servicing of the LLC and/or trust (approximately $3K per year). Total ongoing expenses of the arrangement, including those mentioned, average 50 basis points or less (per year) over the life of the contract. The life insurance illustration provided directly from the insurer was net of fees for both the cash value and the death benefit.

The goal of the time series simulation was to hold constant as many variables as possible to isolate the tax alpha associated with PPLI. Tax alpha would be defined as the additional increase of a family's net worth through legitimate tax planning and asset location techniques. In the investment arena, alpha is used to describe the extra performance that a manager can skillfully generate to outperform ordinary market returns. Similarly, tax alpha through proper asset location can add significantly to a family's net worth and planned giving by utilizing and optimizing sound tax strategies across all available options. For a deeper dive, Table 2 highlights the annual growth of the S&P500 (inside of a standard tax account) vs. PPLI.

Table 2

Analytical Model of S&P 500 vs. PPLI

Annual Growth of S&P 500 (standard tax account) vs. Private Placement Life Insurance

	S&P 500	PPLI
Dividend Rate	2.0%	0.0%
Growth	12.00%	12.00%
Year 22+	9.00%	9.00%

	Tax Rate	Percentage
Ordinary Income	37.00%	0.00%
2026 Rate	39.60%	0.00%
Capital Gains	20.00%	0.00%
Obama Care	3.80%	0.00%
State Income Tax	7.00%	Washington
Management Fee	0.15%	

Year	Year	Age	Beginning of Year Investment Account Balance	Income Withdrawal	Contribution	Earnings	Qualified Dividend	Federal Tax	State Tax	Obamacare Tax	Total Dividend Taxes	LT Capital Gains Tax	Investment Account Balance	Fraction of Cost Basis	Management Fee	End of Year Investment Account Balance
2021	1	44	0		1,500,000	180,000	30,000	6,000	2,100	1,140	-9,240		1,670,760	89.78%	-1,253	**1,669,507**
2022	2	45	1,669,507		1,500,000	380,341	63,390	12,678	4,437	2,409	-19,524		3,530,324	84.98%	-3,900	**3,526,424**
2023	3	46	3,526,424		0	423,171	70,528	14,106	4,937	2,680	-21,723		3,927,872	76.38%	-5,591	**3,922,281**
2024	4	47	3,922,281		0	470,674	78,446	15,689	5,491	2,981	-24,161		4,368,794	68.67%	-6,218	**4,362,575**
2025	5	48	4,362,575		0	523,509	87,252	17,450	6,108	3,316	-26,873		4,859,211	61.74%	-6,916	**4,852,294**
2026	6	49	4,852,294		0	582,275	97,046	19,409	6,793	3,688	-29,890		5,404,680	55.51%	-7,693	**5,396,987**
2027	7	50	5,396,987		0	647,638	107,940	21,588	7,556	4,102	-33,245		6,011,380	49.91%	-8,556	**6,002,824**
2028	8	51	6,002,824		0	720,339	120,056	24,011	8,404	4,562	-36,977		6,686,185	44.87%	-9,517	**6,676,668**
2029	9	52	6,676,668		0	801,200	133,533	26,707	9,347	5,074	-41,128		7,436,740	40.34%	-10,585	**7,426,155**
2030	**10**	**53**	7,426,155		0	891,139	148,523	29,705	10,397	5,644	-45,745		8,271,549	36.27%	-11,773	**8,259,775**
2031	11	54	8,259,775		0	991,173	165,196	33,039	11,564	6,277	-50,880		9,200,068	32.61%	-13,095	**9,186,973**
2032	12	55	9,186,973		0	1,102,437	183,739	36,748	12,862	6,982	-56,592		10,232,818	29.32%	-14,565	**10,218,254**
2033	13	56	10,218,254		0	1,226,190	204,365	40,873	14,306	7,766	-62,944		11,381,500	26.36%	-16,200	**11,365,300**
2034	14	57	11,365,300		0	1,363,836	227,306	45,461	15,911	8,638	-70,010		12,659,126	23.70%	-18,018	**12,641,107**
2035	15	58	12,641,107		0	1,516,933	252,822	50,564	17,698	9,607	-77,869		14,080,171	21.31%	-20,041	**14,060,130**
2036	16	59	14,060,130		0	1,687,216	281,203	56,241	19,684	10,686	-86,610		15,660,735	19.16%	-22,291	**15,638,444**
2037	17	60	15,638,444		0	1,876,613	312,769	62,554	21,894	11,885	-96,333		17,418,725	17.22%	-24,793	**17,393,932**
2038	18	61	17,393,932		0	2,087,272	347,879	69,576	24,352	13,219	-107,147		19,374,057	15.48%	-27,576	**19,346,481**
2039	19	62	19,346,481		0	2,321,578	386,930	77,386	27,085	14,703	-119,174		21,548,885	13.92%	-30,672	**21,518,213**
2040	**20**	**63**	21,518,213		0	2,582,186	430,364	86,073	30,125	16,354	-132,552		23,967,847	12.52%	-34,115	**23,933,732**
2041	21	64	23,933,732		0	2,872,048	478,675	95,735	33,507	18,190	-147,432		26,658,348	11.25%	-37,944	**26,620,404**
2042	22	65	26,620,404	-1,000,000	0	2,305,836	512,408	102,482	35,869	19,472	-157,822	-$274,393	27,494,026	10.91%	-40,586	**27,453,440**
2043	23	66	27,453,440	-1,000,000	0	2,380,810	529,069	105,814	37,035	20,105	-162,953	-$275,460	28,395,837	10.56%	-41,887	**28,353,950**
2044	24	67	28,353,950	-1,000,000	0	2,461,855	547,079	109,416	38,296	20,789	-168,500	-$276,540	29,370,765	10.21%	-43,294	**29,327,471**
2045	25	68	29,327,471	-1,000,000	0	2,549,472	566,549	113,310	39,658	21,529	-174,497	-$277,630	30,424,816	9.86%	-44,814	**30,380,002**
2046	26	69	30,380,002	-1,000,000	0	2,644,200	587,600	117,520	41,132	22,329	-180,981	-$278,727	31,564,495	9.50%	-46,458	**31,518,036**
2047	27	70	31,518,036	-1,000,000	0	2,746,623	610,361	122,072	42,725	23,194	-187,991	-$279,827	32,796,842	9.15%	-48,236	**32,748,606**
2048	28	71	32,748,606	-1,000,000	0	2,857,375	634,972	126,994	44,448	24,129	-195,571	-$280,927	34,129,482	8.79%	-50,159	**34,079,324**
2049	29	72	34,079,324	-1,000,000	0	2,977,139	661,586	132,317	46,311	25,140	-203,769	-$282,024	35,570,671	8.43%	-52,237	**35,518,433**
2050	**30**	**73**	35,518,433	-1,000,000	0	3,106,659	690,369	138,074	48,326	26,234	-212,634	-$283,114	37,129,345	8.08%	-54,486	**37,074,859**
2051	31	74	37,074,859	-1,000,000	0	3,246,737	721,497	144,299	50,505	27,417	-222,221	-$284,195	38,815,180	7.73%	-56,918	**38,758,263**
2052	32	75	38,758,263	-1,000,000	0	3,398,244	755,165	151,033	52,862	28,696	-232,591	-$285,263	40,638,652	7.38%	-59,548	**40,579,105**
2053	33	76	40,579,105	-1,000,000	0	3,562,119	791,582	158,316	55,411	30,080	-243,807	-$286,316	42,611,101	7.04%	-62,393	**42,548,709**
2054	34	77	42,548,709	-1,000,000	0	3,739,384	830,974	166,195	58,168	31,577	-255,940	-$287,350	44,744,803	6.70%	-65,470	**44,679,333**
2055	35	78	44,679,333	-1,000,000	0	3,931,140	873,587	174,717	61,151	33,196	-269,065	-$288,363	47,053,045	6.38%	-68,799	**46,984,246**
2056	36	79	46,984,246	-1,000,000	0	4,138,582	919,685	183,937	64,378	34,948	-283,263	-$289,352	49,550,213	6.05%	-72,401	**49,477,812**
2057	37	80	49,477,812	-1,000,000	0	4,363,003	969,556	193,911	67,869	36,843	-298,623	-$290,316	52,251,876	5.74%	-76,297	**52,175,578**
2058	38	81	52,175,578	-1,000,000	0	4,605,802	1,023,512	204,702	71,646	38,893	-315,242	-$291,253	55,174,886	5.44%	-80,513	**55,094,373**
2059	39	82	55,094,373	-1,000,000	0	4,868,494	1,081,887	216,377	75,732	41,112	-333,221	-$292,161	58,337,484	5.14%	-85,074	**58,252,410**
2060	**40**	**83**	58,252,410	-1,000,000	0	5,152,717	1,145,048	229,010	80,153	43,512	-352,675	-$293,039	61,759,413	4.86%	-90,009	**61,669,404**
2061	**41**	**84**	61,669,404	-1,000,000	0	5,460,246	1,213,388	242,678	84,937	46,109	-373,724	-$293,885	65,462,042	4.58%	-95,349	**65,366,694**

Our time series analysis has tax alpha at the center of its focus, as it seeks to hold investment performance constant (both public and private equity at 12%, then 9% during retirement distributions to reflect risk tolerance objectives). Furthermore, the focus of the research has to do with recreating the same after-tax distribution from the PPLI contract as from the S&P 500 standard account. The same contributions are invested at the same intervals, with the same after-tax deposits to the client's bank at the same intervals. Historically, private equity has outperformed public equity, but for sake of comparison, I ran both investments with the same performance to highlight the value of the asset location. For the inheritance to the children, I used the combined federal estate tax exemption amount of $23.4M for a married couple.

Anything over the inheritance amount of $23.4M was allocated to charity (i.e., family foundation, DAF, or named charity) from the original $3M investment at death.

Once I had the various assumptions, I created a time series analysis of wealth into the third generation as determined by 40-year intervals, for a total of 80 years. I ran the illustrations at the historic 25-year U.S. Private Equity Index return of 12% as indicated by the Cambridge Associates research on U.S. private equity and selected benchmarks (2019) that can be found in Table 3. This analytical model took into consideration tax rates based on current tax law. It should be noted that if tax rates increase, the tax alpha or tax savings will increase further. Once the time series analysis was completed, I measured the tax alpha that was generated through asset location in their family net wealth into the third generation. This result was contrasted against a similar 44-year-old female investing the same $3M directly in the S&P 500 Index, a hedge fund, or a private credit investment (all three in a standard account). The difference between the control group and each of the scenarios provided a clear picture and quantitative analysis on the various tax and planned giving benefits associated with the PPLI phenomenon.

Table 3

Historical Index Performance as of 2019

INDEX	1-QUARTER	1-YEAR	3-YEAR	5-YEAR	10-YEAR	15-YEAR	20-YEAR	25-YEAR
CAMBRIDGE ASSOCIATES LLC US PRIVATE EQUITY INDEX®1	**-1.66**	**10.69**	**14.07**	**11.75**	**14.33**	**13.35**	**12.03**	**13.21**
Bloomberg Barclays Capital Government/Credit Bond Index	1.46	-0.42	2.19	2.53	3.46	3.85	4.54	5.09
Dow Jones Industrial Average Index	-11.31	-3.48	12.94	9.70	13.16	8.18	7.27	10.11
Dow Jones US Small Cap Index	-18.23	-10.68	6.90	4.43	13.01	8.13	8.79	9.41
Dow Jones US TopCap Index	-13.51	-4.32	9.28	8.40	13.30	8.03	5.82	9.06
Nasdaq Composite Index*	-17.54	-3.88	9.84	9.70	15.45	8.31	5.69	8.96
Russell 1000® Index	-13.82	-4.78	9.09	8.21	13.28	7.93	5.85	9.14
Russell 2000® Index	-20.20	-11.01	7.36	4.41	11.97	7.50	7.40	8.28
S&P 500 Index	-13.52	-4.38	9.26	8.49	13.12	7.77	5.62	9.07
Wilshire 5000 Total Market Index	-14.29	-5.26	9.12	8.08	13.20	8.00	6.06	9.03

Note. US Private Equity Index and Selected Benchmark Statistics, Cambridge Associates LLC (2019)

Analytical Model - Observations and Findings

The cross-generational time series analysis involved a fictional main street business owner named Kristina Kristoferson, a healthy 44-year-old female who lives in Seattle, Washington. She has two children, Annika (daughter age 10) and Erikson (son age 8), and is married to Leif who works as an electrician (age 46). Full details of the case study, model, and results can be found in Appendix D and Appendix E.

In the analysis, monthly income needs were $22,000 with a 3% inflation adjustment. Kristina just sold her chocolate business for $10M. Being the generous actor that she is, she contributed $1M to a DAF to serve the poor in her community. After paying $1,800,000 in taxes to the federal government for capital gains, $630,000 to Washington for capital gains, and $342,000 to the federal government for the Affordable Care Act (ACA), she is left with $6,228,000 for investments. $3,228,000 will be placed in an investment account to provide short and mid-term monthly income, while $3M will be placed in a South Dakota LLC, which will purchase a PPLI policy for $3M (which will be deposited over the first two years into the policy and retain non-MEC status under the new 7702 guidelines).

Prior to the sale of her business, Kristina's assets included the following: a 401(k) plan with $500K, $100K in a bank account, $150K of life insurance cash value, an investment property at Suncadia with $500K of equity value, and a primary residence in Ballard worth $1M of which she owes $400K at 3.5% on a 30 year fixed mortgage.

The inputs were carefully placed within a financial plan to understand what the outcome might look like in 40 years at age 84. Kristina would need income to support her living expenses, and the driving goals for her and Leif would be to minimize the tax liability, increase their asset protection, and create a stable lifetime income. They also wish to fund philanthropic pursuits.

I ran a scenario where the qualified retirement plan assets were rolled into an Individual Retirement Account (IRA) and appreciated at 7%. Income began at 59 ½ once the penalties were to be removed for accessing the funds. The $100K at the bank assumed a 1% rate of return on savings and deposits. The traditional life insurance cash value appreciated at a 4% rate, along with the residential and investment real estate. Further, I added the PPLI withdrawal at age 65 of $1,000,000 per year tax-free in the form of a withdrawal of basis and then loans. Keep in mind that these loans were to be repaid from the death benefit and are not intended to be repaid during the insured's lifetime. Furthermore, there are no underwriting requirements for the loans, making them nearly synonymous with a withdrawal. The loans will not be repaid during Kristina's life, but rather by a reduction of the death benefit, thereby keeping them tax-free.

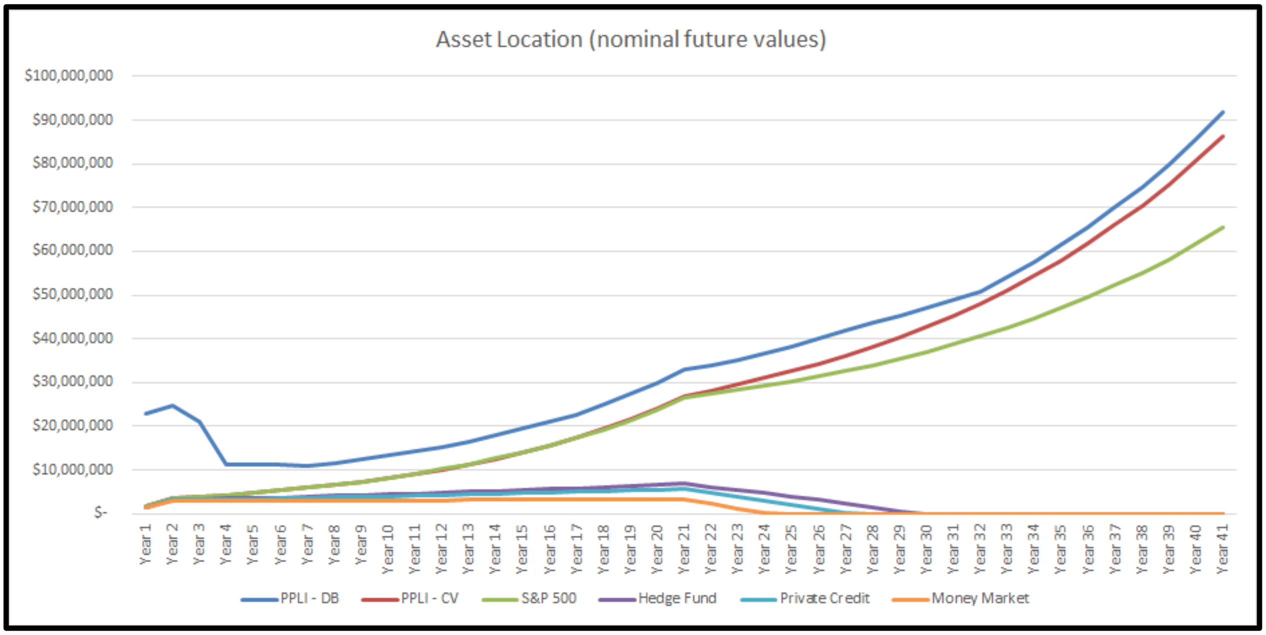
The distribution priority was set in the following sequence: 1) a $3.2M investment account, 2) IRA over lifetime, and 3) PPLI withdrawals. This sequence mirrors the common rule by Coopersmith et al. (2010) of withdrawals from taxable, then tax-deferred, and finally tax-exempt distributions. Assuming monthly income beginning at age 44 through age 84 and supplementing the income need from the PPLI beginning with withdrawals of $1M per year at age 65, her non-PPLI overall asset values would be approximately: 1) Primary residence ($2,845,847), 2) Vacation rental/investment property in Suncadia ($2,371,539), 3) Life insurance cash value ($711,461), 4) investment account ($32,608,717), and 5) side fund investment account of extra unused income from PPLI ($26,066,555). The total non-PPLI assets would equal approximately $62M and would be subject to WA estate tax.

Since I already had the illustration data from the life insurance carrier, I needed to compare it with an S&P 500 investment and model the same growth and distributions. I started in a spreadsheet with a beginning of the year investment account (indicating the calendar year, age, and policy year) balance and then made a separate column for new contributions. The balance was multiplied by the assumed interest rate of 12% in years 1-21, then adjusted to 9% thereafter to calculate the investment earnings. The earnings were further segmented into unrealized capital gains and qualified dividends. The qualified dividends were estimated to be 2% of the overall 9% return. In the model, all other standard deductions had been taken already and the case study explains the personal financial situation of Kristina Kristoferson. The dividends were assessed a long-term capital gains tax of 20% plus a state income tax of 7% (Washington) plus an ACA tax of 3.8%. These combined dividend taxes were deducted from the investment account balance. Further, I built an option to assess a management fee on the investments, which I kept low for the S&P 500 at 15 basis points. For example, a hedge fund might charge 2% on assets and a 20% of profit as carried interest. The 15 basis points is incredibly low and could potentially be reduced further through the process of direct indexing, but it would not have a significant impact on the calculations at hand. Further taxes were assessed beginning in year 22, when the after-tax income of $1M is distributed annually (from age 65-84). Due to the tax efficiencies of the S&P 500 (buy and hold), the distributions above the cost basis at age 65 are taxed as capital gains, and I further calculated the fraction of cost basis to reflect the portion of returned capital on a tax-free basis.

The prior quantitative analysis of comparing the same after-tax inputs and retirement outputs of PPLI with the S&P 500 was also applied to hedge funds, private credit, and money market. Not surprisingly, the S&P 500 had the best results compared to the other asset classes, but still was unable to match the same after-tax outputs as the PPLI arrangement as can be seen in Figure 1.

Figure 1

Expected After-Tax Performance of Different Asset Classes vs. PPLI



The hedge fund underperformance was due to a management fee of 2% and a high turnover rate, resulting in substantial short term capital gains taxes. Additionally, the hedge fund was modeled with a 12% return throughout the 40-year analysis. Private credit had a smaller management fee than the hedge fund at 1%, but still underperformed due to a reasonable estimate of 8% return for this asset class combined with an ordinary income tax on all interest. Money market underperformed by the widest margin due to a reasonable estimate of 1% total annual return and, like private credit and hedge funds, its tax inefficiency.

Other limitations of the S&P 500 in contrast to the PPLI arrangement include the inability to re-allocate to a more conservative portfolio at age 65 without incurring significant tax liability. Furthermore, the additional tax deducted to cover the tax on the annual $1M retirement withdrawal would create tax liability on the extra amount. This was not calculated but could be included in future research. The cost of insurance was included in the illustration and protects the family from the risk of premature death. Essentially, it completes the financial plan with a tax-free death benefit, whereas an investment account would not. For example, if the family began the S&P 500 investment account and a premature death occurred at the end of year two, there would be approximately $3.5M for the family, as opposed to the PPLI arrangement which would provide $24M income tax free. The capital gains rate as of 2021 is historically low at 20% and is likely to increase in the future. This makes the PPLI arrangement more attractive vs. the S&P 500. The state income tax rate of 7% (Washington) is a moderate level compared to other states. If an individual lived in California (13%) or New York, the PPLI arrangement would compare more favorably. Inversely, I used South Dakota as the state with one of the lowest premium taxes in the insurance illustration and, if the policy used a different jurisdiction (i.e., California at 2.35%), the premium tax would jump from $4,900 to $70,500. Although this is a significantly higher amount of premium tax, it does not have a material impact over 40 years.

The $3M contributed into the PPLI policy benefits from favorable tax treatment as a life insurance policy. I assumed a 12% growth rate on the private equity allocation inside the PPLI policy. At age 65, I adjusted the allocation to be more conservative as an alternative income or private credit allocation yielding 9%. This reflects a more conservative investment mandate at age 65+. At age 65, the PPLI policy is scheduled to distribute $1M per year until age 84.

At age 84, given the aforementioned assumptions, the cash value of the policy is approximately $86,451,900 and, due to the life insurance corridor, the death benefit is $91,709,501. The entire death benefit is income tax free, but in a non-ILIT structure, the death benefit is impacted by corresponding federal and state estate taxes. This amount would allow Kristina and Leif to have the federal exemption amount excluded from taxation at $23.4M and paid directly into a dynasty trust for the benefit of the family. In 2021, the federal estate tax exemption amount is $11.7M and can be doubled for a married couple ($23.4M). This also allows her to have their family foundation, DAF, or favorite charity receive over $68M to zero out the remaining estate tax liabilities. Next, I applied Washington estate tax and, after calculating it, I was able to deduct it from the federal estate tax liability. In Washington, the estate tax applies to assets over $2,193,000 per person in 2021. Estates in Washington that exceed the exemption amounts are subject to a progressive estate tax, 10% to 20%. Interestingly, the Washington estate tax exemption amount has remained at the same level since 2018, as the original inflation index it was tied to no longer exists. The Department of Revenue has been using the last consumer price index (CPI) figure for Seattle CPI, which resulted in no increase in the applicable exclusion amount for 2021. Given that property values have increased significantly in Seattle over the previous few years, I would expect to see a higher applicable exclusion amount in the coming years, which may result in a reduced revenue stream for the Washington government. Perhaps, the political will to increase the exemption amount with rising costs of living may be currently lacking.

In this example, the two children, Annika and Erikson, would be receiving an inheritance of approximately $62M combined, have a board seat (and possibly an employment engagement with the family foundation), and be the beneficiaries of a family bank dynasty trust that would establish a second PPLI policy with the $23.4M federal exemption amount that would be capable of distributing $4.4M per year beginning in year 10. The dynasty trust would also provide distributions for property taxes on family real estate, health and medical expenses for family members, private tuition, other educational costs, first home purchase, business start-up seed capital, professional development, graduate school tuition, retirement security, and other distributions at the discretion of the trustees.

The analysis concluded with the balance of the dynasty trust after 40 years of $318M, after making annual distributions of $4.4M per year beginning in the tenth year of the arrangement. In contrast, and keeping all variables equal, I ran an analysis of G2 wealth with the same after-tax amount of $23.4M invested directly in the S&P 500 at a 12% return. The after-tax distributions of $4.4M to Annika and Erikson began in year 10 and were paid annually for 30 years. At the end of the period, the S&P 500 had a balance of $238,363,180 which is subject to estate tax at the State and Federal levels. The Washington estate tax was calculated by subtracting the exclusion amount of $2,193,000 and then subtracting the estate tax for the first $9M over the exclusion amount (which was $1,490,000) and then multiplying the remaining amount over $9M by the 20% tax rate. Total Washington estate taxes equaled $46,924,036. The Federal Estate tax was then calculated by reducing the taxable amount by 1) WA estate tax of $46,924,036, 2) the Federal estate tax exclusion amount of $23,400,000, and 3) the stated tax on the first $1M of $345,800. This allowed me to calculate the federal estate tax on the amount over $1M at the rate of 40%, which was $66,677,338. The total federal estate tax was $67,023,138. When the federal and state estate taxes were added together, the resulting total estate tax was $113,947,173. Next, I subtracted the total estate taxes from the inheritance to G3 which produced the after-tax inheritance of $124,416,006. When I applied the same estate tax calculation to the dynasty trust, it resulted in a zero-tax liability, as the assets are not transferring to another person (they were staying in trust). Hence, the combination of tax alpha through asset location for G2 was much higher and resulted in an extra $218,367,210 on a post-testamentary basis.

The purchasing power of future dollars is likely not be what it is today due to the corrosive nature of inflation, or the decline in purchasing power of a given currency over time. If one wanted to calculate the effect of inflation on the sum, they could reduce the investment performance assumption by what they might deem to be the inflation rate (3%) to identify the real vs. nominal value. The nominal value would be measured in total dollars, whereby the real value is measured against goods or services. The most utilized inflation index is the CPI, which is published by the U.S. Bureau of Labor and Statistics. Inflation is considered by many professionals as a hidden tax because it originates with an elastic money supply from the governing bodies and results in less purchasing power for the people being governed. On the other side, inflation can be beneficial to the government because it provides additional revenue from taxes on raising wages. Furthermore, it reduces real borrowing costs when the loans are fixed in the amount due. Essentially, both taxes and inflation benefit the government with additional resources. Through controlling the money supply, governing bodies possess the ability to debase the value of the currency held by its citizenry.

Investment advisors will generally point to real assets such as commercial industrial real estate or multi-family real estate as an inflation hedge for both equity and income streams. For example, a multi-family real estate property raising rents to keep up with prevailing business costs, while simultaneously recapturing inflation through the increase in equity value. Inflation was not calculated in the next section as it would essentially affect the purchasing power of the income stream similarly in all cases. However, real versus nominal returns should be considered when running long-term calculations. For perspective on the impact of inflation, the ending nominal value of the S&P 500 at the end of G1 was $65,366,694 whereas the real value would have a reduced purchasing power (most likely by about 69%). For example, using a 3% inflation rate, every $1M in 2061 would be equivalent to only $306,557 in 2021.

Analytical Model - Sensitivity Analysis

Once I established the baseline results, it was important to conduct a sensitivity analysis to any changes to key variables such as: 1) Federal income tax rates, 2) State tax rates, 3) Federal capital gains tax rates, 4) investment rates of return, 5) dividend rate of the S&P 500, 6) management fees, and 7) ACA tax rates. I am quite certain that tax rates will adjust in both the short and long term, therefore I wanted to understand the implications of potential changes from the baseline (current) assumptions. Table 4 showcases this analysis.

Table 4

Sensitivity Analysis

	G1 PPLI vs. S&P 500 Sensitivity Analysis						
	More Efficient Variables	Ending Value	Baseline S&P 500 Ending Value	Current Assumptions and Variables	Baseline PPLI Ending Value	Less Efficient Variables	Ending Value
Federal Income Taxes	32%	$ 65,366,694	$ 65,366,694	37%	$ 91,709,501	42%	$ 65,366,694
State Taxes	0%	$ 74,151,033	$ 65,366,694	7%	$ 91,709,501	13.3%	$ 57,846,326
Federal Capital Gains Taxes	15%	$ 71,594,465	$ 65,366,694	20%	$ 91,709,501	28%	$ 55,878,367
Investment Rate of Return	Increased by .5%	$ 87,431,658	$ 65,366,694	12% and 9%	$ 91,709,501	Reduced by .5%	$ 47,387,545
Dividend Rate	1%	$ 78,427,737	$ 65,366,694	2%	$ 91,709,501	3%	$ 53,853,418
Management Fee	0%	$ 71,787,186	$ 65,366,694	0.15%	$ 91,709,501	0.75%	$ 43,433,649
ObamaCare Taxes	0.0%	$ 70,078,581	$ 65,366,694	3.8%	$ 91,709,501	6.0%	$ 62,699,552

When I analyzed the same inputs and outputs in different state jurisdictions, it created differing amounts of tax alpha. The S&P 500 is fairly tax efficient on a buy and hold strategy, but the dividends and capital gains from the distributions had a different outcome based on the state. As one might imagine, the higher the state income tax, the higher the tax alpha created by utilizing the PPLI arrangement. Wyoming had an ending value for the S&P 500 of $74M, while the same account held by a California resident would have an ending value of $57M. The results of jurisdictional tax sensitivity can be seen in Table 5.

Table 5

Jurisdictional Tax Sensitivity

	Tax Rate	Tax Level	S&P 500 (stepped up basis)	PPLI Amount	Tax Alpha
Wyoming	0%	Low	$ 74,151,033	$ 91,709,501	$ 17,558,468
Washington	7%	Medium	$ 65,366,694	$ 91,709,501	$ 26,342,807
California	13%	High	$ 57,846,326	$ 91,709,501	$ 33,863,175

Perhaps the most important sensitivity analysis is the federal long term capital gains tax rate which is currently 20% (plus 3.8% ACA tax). There has been much discussion about raising the capital gains tax to 28%. This led me to run an additional analysis with a 28% capital gain tax applied to all state jurisdictions in addition to any further state taxes. The difference between the S&P 500 value at the end of the series related to G1 finished at $65,366,694 in the model whereas at the 28% level the value finished at $55,878,367. The PPLI remained unchanged at $91,709,501. When the ACA tax was adjusted from 0% to 6%, it had a minimal impact. The ACA baseline was $65,366,694. At 6% it was $62,699,552 and at 0% it was $70,078,581.

Initially, I did not feel it was appropriate or necessary to conduct a sensitivity analysis based on potential investment returns, as I felt it was more accurate to hold all variables constant by comparing both private and public equity at a 12% return sequence to isolate the alpha related to the asset location. However, when the S&P 500 investment return was reduced by 0.5% and the PPLI variables remained the same, it produced a value of $47,387,545. Conversely, when the S&P 500 investment return was increased by 0.5% and the PPLI variables remained the same, it produced a value of $87,431,658. This turned out to be a major finding as the construct added over 50 basis points of measured alpha on that point alone. Even after giving the S&P 500 an extra return of 50 basis points, it still was short of the PPLI ending value of $91,709,501.

Due to the way that the S&P 500 was modeled (tax efficient, buy and hold for 40 years with no reallocation), the federal income tax would not apply to either the S&P 500 or the PPLI arrangement. However, hedge funds and private credit would be adversely impacted. Only the dividends are taxed in a buy and hold strategy and they represent approximately 2% return (of the total 12%). These dividends are taxed as qualified dividends and enjoy a more preferential long term capital gains tax rate. Hence, the S&P 500 dividend rate had a major impact on the results. If the dividend rate increased to 3%, the result would be only $53,853,418. On the other hand, if the dividend rate decreased to 1%, the result would be $78,427,737. This further highlights the advantages of tax-free vs. taxable distributions.

This case study represented an incredible result of Kristina impacting her society with $68M, which in her philanthropic pursuits will be used to eradicate homelessness in Ballard. Further, her children were well provided for in their vulnerable years, and her grandchildren were provided for with a significant pool of capital from a dynasty trust ($118,367,210) for their benefit and an additional $100M to the family foundation.

This level of wealth requires coaching and support for the children and grandchildren on both the quantitative and qualitative levels. From a qualitative perspective, we would recommend that a private trust company or multi-family office be utilized to support the children and grandchildren with facilitated family retreats and ongoing education/support around the philosophy of wealth. From a quantitative point of view, it would be prudent to have a robust and transparent accounting platform or team to analyze all aspects and family office transactions across various entities and trusts. Further, it is recommended for the family to engage a RIA as a family office CFO and fiduciary to help select and identify appropriate investment opportunities, allocate across different investments in accordance with an investment policy statement, and manage capital calls. The duties of a family CFO are centered around managing capital calls, directing cash flow, and overseeing financial planning across all entities and assets while proposing corrective actions to optimize family wealth and minimize tax liabilities. A family CFO operates from a balance sheet perspective, looking primarily at the family balance sheet as their starting point for building and maintaining the financial infrastructure across all trusts, business ventures, real estate assets, investment accounts, qualified plans, DAFs, family foundations, irrevocable trusts, and other structures. The family CFO is also responsible for drafting and adhering to the family office investment policy statement, which can set the parameters for asset allocation, asset liquidity, and asset location. The investment policy statement delivers an objective and intelligent approach to an investment thesis and may be less susceptible to emotional or irrational investment maneuvers. Finally, the Family CFO acts as a quarterback or general contractor among other professional advisors including, but not limited to, CPAs/accountants, bookkeepers, insurance brokers, asset managers, estate attorneys, real estate professionals, business attorneys, controllers/business managers, private bankers, and outside philanthropic contacts. This coordinated effort can deliver a more intelligent and informed decision-making process on behalf of the family in relation to the family wealth. RIAs typically have access to technology platforms and alternative investment opportunities outside the reach of the general public.

CHAPTER 5: DISCUSSION

Overview

PPLI is commonly used in the financial architecture of the UHNW. Deferred compensation plans can also be structured utilizing PPLI which is often the case with insurance company owned life insurance (ICOLI) and bank owned life insurance (BOLI). Small to mid-sized business families and HNW seem uniquely suited for PPLI, but most have never heard of it and could be missing out on a legitimate arrangement that could enhance their planned giving. Based on the results, it seems that many HNW business families are interested in understanding techniques to increase creditor protection, minimize taxes, and invest in alternative assets such as private equity.

I believe that there remains an asymmetry of knowledge between UHNW family offices and HNW advisors regarding PPLI, as the PPLI arrangement is highly complex and often difficult for advisors to communicate. Insurance agents and advisors to the HNW do not get paid traditional commission to facilitate a PPLI arrangement, which seems to have slowed the adoption rate among their business family clients. The academic literature is nascent and provides limited clarity on how the structure is currently utilized by UHNW, deferred compensation plans, and banks. Furthermore, there seems to be no academic or practitioner literature on how to utilize the PPLI construct to increase a family's planned giving. Unfortunately, this leaves the small to mid-sized business families and HNW who seem uniquely suited for PPLI without the knowledge or tools that are commonplace in the UHNW family office. Which led me to research the following questions:

- Among the HNW population, does there exist a latent interest in the features and benefits of a PPLI arrangement?
- Why does PPLI seem underutilized by high net-worth business families, while the arrangement appears much more common among UHNW family offices?
- How is PPLI commonly structured for U.S. UHNW individuals, U.S. HNW individuals, and foreign UHNW individuals?
- Is it possible for a business family to structure a PPLI policy to create the same after-tax financial outputs (retirement income and inheritance to children) as a standard account arrangement, with additional assets going to 501(c)3 charities for enhanced planned giving?

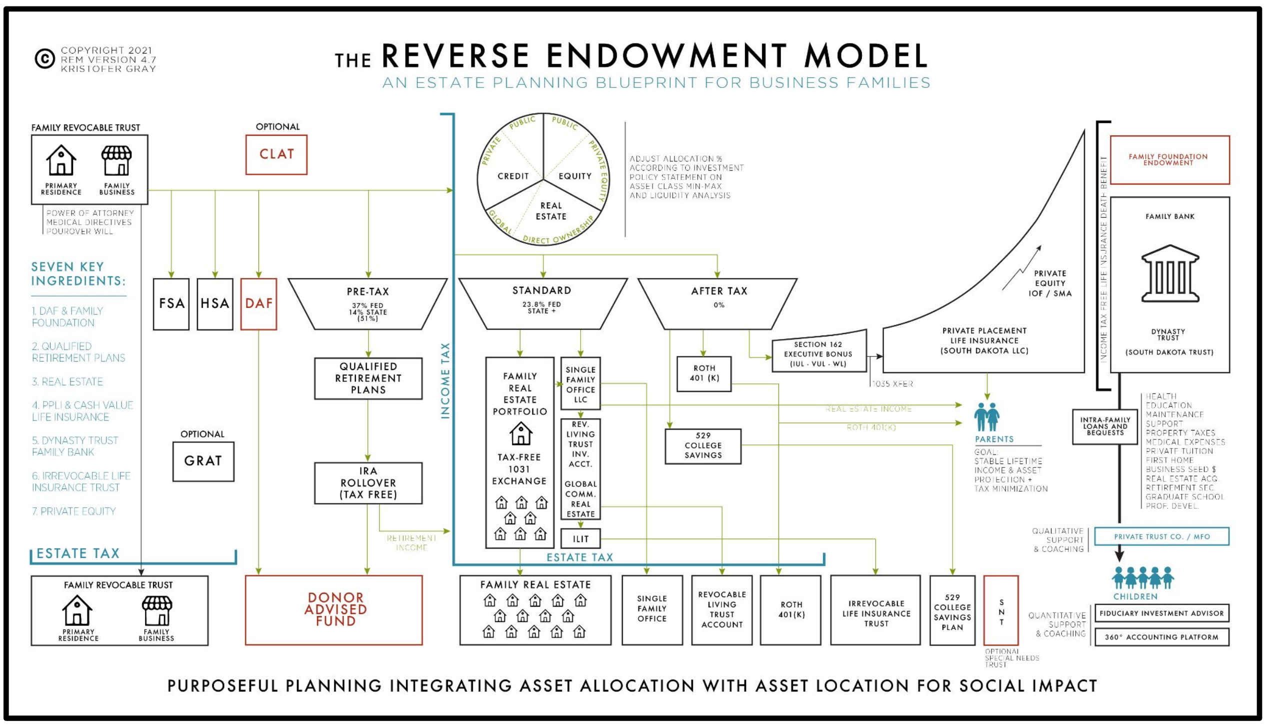
The surveys indicated that there does exist a latent interest in the features and benefits of the PPLI arrangement among the HNW demographic. The interviews revealed that the sophistication of the PPLI arrangement and the reduced compensation to the insurance agent attribute to the underutilization and asymmetry of knowledge regarding the structure. Further, the interviews revealed the most common structure of the arrangement for US UHNW individuals, US HNW individuals, and foreign UHNW individuals. Finally, the analytic model demonstrated that it is possible for a business family to structure a PPLI policy to create the same after-tax financial outputs (retirement income and inheritance to children) as a standard account arrangement, with additional assets going to 501(c)3 charities for enhanced planned giving.

Implications for Advancing Theory - Reverse Endowment Model

This is an introduction to The Reverse Endowment Model. The model incorporates a non-modified endowment (non-MEC) contract to create a testamentary endowment for the family foundation and an additional pool of capital within a dynasty trust incorporating a family bank concept. The Reverse Endowment Model is a cross-generational process of building wealth while incorporating planned giving. There are seven critical ingredients to the model that have been observed from experience as a practitioner, either using them firsthand or working with business families on these topics. The seven key ingredients that are included in the model are DAFs and family foundations, qualified retirement plans, real estate, PPLI, dynasty trusts and family banks, ILITs, and private equity and the private markets.

Figure 2

The Reserve Endowment Model



PPLI is often useful in the advanced planning for the UHNW single-family office. However, there seems to be an asymmetry of knowledge about the arrangement between UHNW and HNW business families, due to recent tax changes in 2017 (The Tax Cuts and Jobs Act) and significant government economic stimulus related to the COVID-19. A unique application of PPLI for HNW with an alternative policy structure (non-MEC), what I call a reverse endowment model, may create a purposeful planning opportunity for business families to increase their planned giving and still pass the same amount of assets to their heirs.

So, what do we know as a practitioner? We know that UHNW banks and insurance companies are actively utilizing the PPLI structure in their corporate owned life insurance arrangement, as is evidenced by the interviews. We also know that upper quartile alternative asset managers are placing their bets in this space. Blackstone acquired Lombard and expanded to Hong Kong and Singapore. KKR and Apollo have created their own insurance dedicated funds. We also know that offshore PPLI insurance providers in Bermuda and the Cayman Islands are prohibited from marketing in the US.

Endowments are keenly aware of the utility of alternative assets. If we look at Yale's endowment from 1981 to 2019, we can see how the asset allocation has shifted over time. Private equity has increased heavily across leveraged buyouts and venture capital, from virtually a 5% allocation in 1989 to approximately 30% today. US domestic equities in 1989, including cash and fixed income combined, were 70% of the endowment. Today the combination of both those represents 10% of the overall endowment. So, clearly the Yale endowment investment managers have taken a strong position in favor of private market investments.

The size of the global HNW population is a hundred times larger than the size of the global UHNW market. The HNW represents the most profitable segment in banking and wealth management. The only demographic whereby the number of life insurance policies being sold each year is increasing is among the financially sophisticated. According to Fidelity Charitable, when it comes to business families, the average household donation of an entrepreneur is more than 400% of a non-entrepreneur. Many small business owners have outdated or underperforming whole life or variable universal life policies that can be recycled into a PPLI policy through a tax-free 1035 exchange. The 2017 Tax Cut and Jobs Act doubled the Federalist state exemption amount and created a unique planning opportunity for HNW families.

The total amount of Roth IRA assets has increased considerably over the past decade through contributions, conversions, and market growth. According to DiLellio and Ostrov (2017, 2020), the total amount of Roth IRA assets in America has increased 500% from 2003 to 2013, while traditional IRA and 401(k) contributions have only doubled during the same period. Why would people be interested in a Roth IRA? I believe the answer has to do with the current federal national debt, which stands at $27 trillion. The current US federal deficit is around $3 trillion, and the federal budget debt servicing is about $300 billion, which accounts for roughly 9% of the federal budget. The above data led Standard & Poor's to downgrade the US credit rating from AAA to AA plus in 2011. This would suggest higher borrowing costs, which would likely be funded by higher taxes in the future.

From the perspective of an investment advisor, there are seven main risks that need to be addressed on behalf of business families making investment decisions. These risks include business risk, market risk, inflation risk, liquidity risk, jurisdictional risk, interest rate risk, and tax risk. Each of these risks can negatively impact a family investment and are described in the glossary of terms in Appendix F. The Reverse Endowment Model seeks to hedge or minimize each of these risks through asset allocation and asset location techniques.

Table 6 showcases how business risk is assessed as low for private credit and public credit because, in a bankruptcy, the debt holders are paid before stockholders. Market risk was assessed to be higher among publicly traded equity and credit due to market swings and behavioral finance phenomena versus the less liquid private equity and credit. Inflation risk was assessed to be the highest for both public and private credit as it is possible to silently work against or even eclipse the actual purchasing power of a credit portfolio's return. Liquidity risk was low for publicly traded equity and credit as an investor can sell and convert to cash within a day. Although jurisdictional risk poses a threat to equities and credit as well, it is most pronounced among real estate as population movements and other political factors could reduce the desirability of a location. Interest rate risk, or the risk of investment losses due to a change in interest rates, was assessed a high value for public credit. The risk that tax rates will change unfavorably and result in losses and less family wealth due to higher-than-expected taxes applies evenly to all asset classes, even though this research illustrates how different asset classes and locations are more tax efficient than others under the current tax laws.

Table 6

Risk Assessments for Various Asset Classes

	Private Equity	Public Equity	Hedge Funds	Private Credit	Public Credit	Real Estate
Business Risk	MED	MED	MED	LOW	LOW	MED
Market Risk	LOW	HIGH	MED	LOW	MED	MED
Inflation Risk	LOW	LOW	LOW	HIGH	HIGH	LOW
Liquidity Risk	HIGH	LOW	MED	HIGH	LOW	HIGH
Jurisdictional Risk	MED	MED	MED	MED	MED	HIGH
Interest Rate Risk	LOW	LOW	LOW	MED	HIGH	MED
Tax Risk	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH

Asset Allocation

The Reverse Endowment Model is an estate planning blueprint for business families. It starts in the middle of the diagram with asset allocation. Many financial advisors will claim that there are three asset classes: stocks, bonds, and cash. However, as a practitioner, I would identify the three true asset classes as credit, equity, and real estate.

Cash is an asset class, but for all intents and purposes it is not viewed as an investment for the long term because current interest rates are at historic lows. Further, with the removal of the gold standard by President Nixon, the intrinsic value of cash today is perhaps tied more closely to US global hegemony and the federal government's ability to tax its constituency rather than the price of gold. When considering asset allocation among business families, it can be broken down into the three aforementioned categories: 1) credit, which could be private or public credit, 2) equity, which could be public or private equity, and 3) real estate, which we would favor direct ownership, but also have some global exposure to income producing real estate around the world to mitigate jurisdictional risk.

The way that investment advisors typically allocate among asset classes is directed by the investment policy statement drafted by the family or the single-family office. Any advisor must pay special attention to the asset class minimum and maximum, as well as overall portfolio liquidity to make sure that capital calls are funded appropriately in private equity, and the portfolio maintains an appropriate level of liquidity for emergencies or other opportunities.

Diversification is key to asset allocation and is one of the driving philosophies that underpins modern portfolio theory. Not only is diversification important across asset classes, but among more skilled investors, it is common to see diversification across vintages, fund managers, and jurisdictions. The alternative assets are a favored investment for many business families, as they are often comfortable with private business and real estate ownership. However, within alternative investments asset liquidity, maintaining the diversification to capture an illiquidity premium and maintain sufficient liquidity for current needs and capital calls is a critical component of investment advisorship among the HNW and UHNW demographic. Not all private equity investments are considered equal. In fact, the term private equity is an expansive term that might include venture, angel, buyout, distressed, primary, direct, secondary, and co-investment, among others. As one might imagine, the investment performance and risk associated with each of these different categories of private equity are varied. Kaplan and Schoar (2005) dissected the performance through the lens of returns, persistence, and capital flows. They concluded that the evidence suggests that older, more experienced funds tend to have better performance. It is important to note that in private markets, there are wide dispersions in returns between the top and bottom quartile performers, which highlights the need for a skilled and knowledgeable advisor to help the investor assist in the asset allocation and access points to top-quartile private equity firms within the private market space. Further, oftentimes an advisor will help establish or curate an investment policy statement to provide parameters on asset classes in accordance with the investment goals and objectives of the family.

Typically, a family revocable trust is established to hold the primary residence and family business interests. One of the reasons for the use of a family revocable trust is to avoid probate. Authenticating the last will and testament of the deceased is the first step of the probate process. If one dies without a will, the estate is considered intestate and the state's probate court takes over the distribution of the estate according to state intestacy laws. Depending on the state, the probate process can be an expensive and time-consuming ordeal of authenticating the last will and testament, appointing the executor or personal representative, locating the decedent's assets, determining date of death values, identifying and notifying creditors, paying the decedent's debts, preparing and filing tax returns, and distributing the estate.

Privacy can be enhanced for the family by using a family revocable trust as it avoids the public probate process and may decrease the overall cost of transferring assets (e.g., court fees, executor fees, attorney's fees, accounting fees, appraisal fees, bond fees). The trust also creates a measure of asset control as a trust can operate for years (or into perpetuity) and property trusts can be carefully planned according to the perceived future needs of beneficiaries. There exists a fiduciary relationship between the trustee and beneficiary and oftentimes a corporate trustee is chosen to provide experience, longevity, and professionalism. A family revocable trust generally also includes a pour over will, which specifies that all property and financial assets owned by the individual transfer to the trust and the control of the trustee at the time of the individual's death. These assets will go through the probate process to be transferred into the trust. Finally, it is common for families to draft powers of attorney (i.e., financial and health care) and advanced medical directives at the time of their trust formation.

Within the family business, the structure is usually an LLC, a C-corporation, or an S-corporation. For asset protection purposes, a sole proprietorship is discouraged as a sole proprietorship is not going to have a corporate veil to protect and shield assets. The final point to highlight on the family revocable trust is that it can be a useful tax tool in community property states to get a double step up in basis. Assets held in the family revocable trust are community property, and get a full step-up in basis for both sides of the community property at the death of the first spouse, even though the surviving spouse's property is not included in the decedent's gross estate for federal estate tax purposes. This presents a planning opportunity for families to consider liquating highly appreciated assets such as a family business or real estate at the time of the first death and diversifying investments to dilute concentration risk.

Next, we move to asset locations related to different tax buckets. There are three different types of investment accounts that can be utilized: a pre-tax account (50% assumed tax rate, 37% Fed and 13% State), a standard account (36.8% assumed tax rate, 23.8% Fed and 13% State), and an after-tax account (0% assumed tax rate).

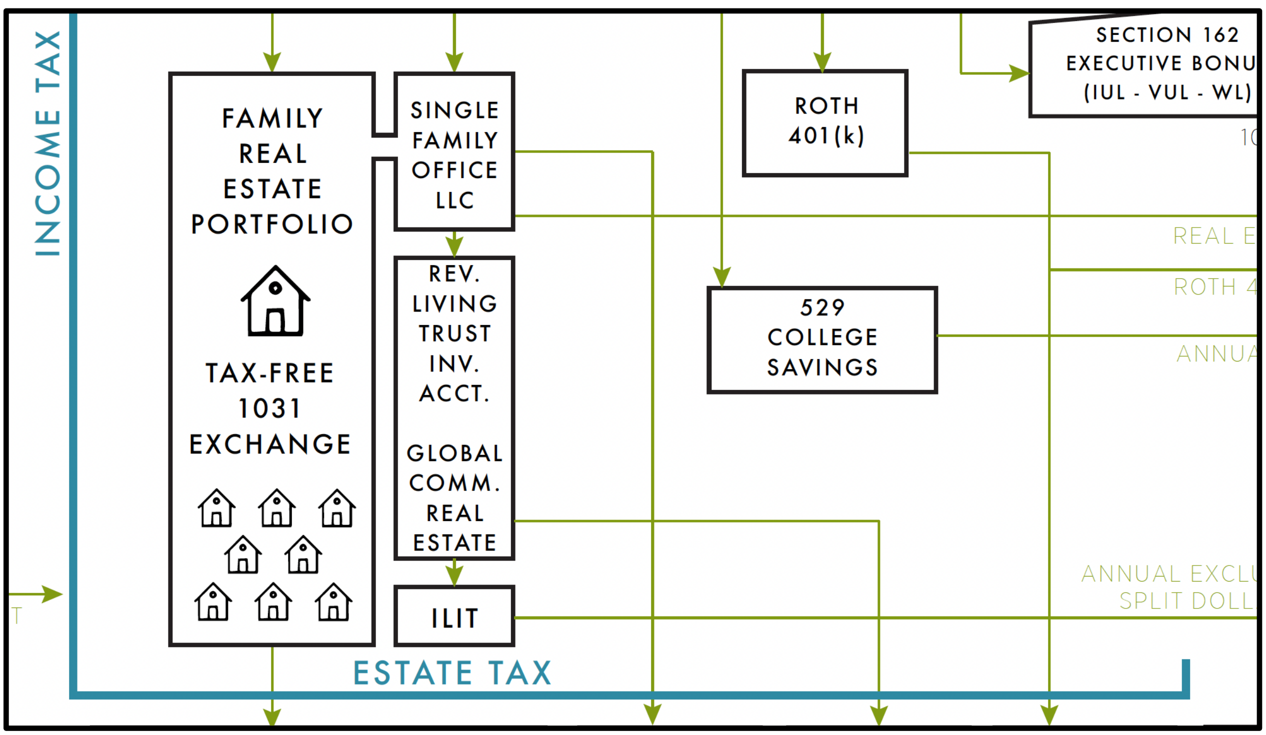
An equity allocation works best in the after-tax bucket because of long term growth opportunities. Equity is generally seen as the highest performing asset class for long term capital appreciation. Equity is most advantageous inside an after-tax bucket such as a Roth 401(k), a Section 162, or a PPLI arrangement. A credit allocation works best in a pre-tax bucket because the interest earned by lending money is considered ordinary income and is currently taxed at the highest level depending on the investor's tax bracket. Because of this, credit belongs best in a pre-tax environment, qualified retirement plan, or a family foundation. Real estate has significant tax benefits of its own and does not need pre- or post-tax arrangement to realize those benefits.

IRAs are typically the least favorable asset to transfer to a non-spousal family member at death because, in a progressive tax structure, the entire balance is categorized as ordinary income. This means that the tax rate gets higher as more assets are distributed. Stretch IRA rules have been truncated, leaving advisors with less tools in a post-testamentary environment to reduce the impact. The IRA is a great tool to provide consistent lifetime income to the investor and their spouse with the remainder going to charity after receiving a lifetime of income. In the Reverse Endowment Model, I recommend a DAF as a named contingent beneficiary to the IRA. All assets contributed to charity bypass taxation entirely and can be immediately deployed by the non-profit into meaningful social causes. Due to the objective of stable lifetime income, it is another reason why credit would belong in this bucket as a stabilizer to the overall financial plan. Theoretically, if one had a 60/40 allocation between stocks and bonds and they were able to apply the allocation universally across their assets, it would be beneficial to have the bonds in the IRA, and stocks in the after-tax account. This way the long-term growth of the stocks is housed within a structure that will not compound an underlying tax liability to the investor.

Considering the tax policy and COVID-19 impact on the federal balance sheet, it makes the after-tax bucket more appealing as an investment vehicle because it is likely that income taxes will not be the same as they are today. The same logic can be applied with capital gains taxes and other estate taxes. Given the budget deficits and current debt levels, it is very likely that those tax liabilities will increase over time to balance budgets and reduce debt obligations. The business owner is no stranger to tax, as is evidenced by the exhaustive list of taxes mentioned previously (e.g., B&O tax, payroll tax), but essentially the primary taxes that need to be planned for are an income tax, which is a vertical line in Figure 3, and an estate tax, which is a horizontal line.

Figure 3

Income vs. Estate Tax Flow in the Reserve Endowment Model



There are some breaks in the horizontal line where certain assets can flow through without being assessed an estate tax. Notably, a DAF, a properly drafted ILIT, a 529 college savings plan, and a third party special needs trust will also transfer estate tax free. Assets held inside an irrevocable dynasty trust or family bank structure are not impacted by estate taxes because there are no assets transferring ownership.

Revocable trust assets will be assessed estate tax at the federal and state levels. The primary residence and the business interests will generally be assessed estate tax. The primary residence held in the family revocable trust does not enjoy the favorable 1031 tax free exchange that only applies to investment properties. However, for a family that experiences capital appreciation on their primary residence, they can sell that property and, if they are married, enjoy the first $500,000 of profit tax free. On a primary residence level, it is advisable to upgrade one's residence or consider selling a current residence once the equity value has appreciated around $600K from the time of purchase. This would be to take advantage of an income tax exclusion at the federal level of the first $500K of capital gain for a property owned by a couple and lived in for at least two of the previous five years. The transfer costs of commissions to realtors and property improvements to prepare the property for sale would likely erode a portion of the profit, which is why the $600K figure is a general rule and will vary depending on the overall market value of property. There is no tax benefit for holding the property beyond the $500K of true net profit, and it is a useful tool that should be considered on an income tax planning basis. In the end, the primary residence will be included in the decedent's estate for estate tax purposes, along with the business interests.

A second optional component of real estate that is beneficial is that some real estate brokerage firms are now offering concierge lending service with 0% interest and no points as a bridge loan to improve the real property, prior to listing. This means that the family does not have to use any liquid capital to prepare and stage the property for sale. This, in turn, can preserve liquid capital and increase the potential sales price simultaneously.

Estate taxes on privately held businesses can be incredibly damaging to the business and may result in layoffs or the draining of capital accounts. For highly appreciating businesses, or those that have steep growth expectations, it can be beneficial to freeze the current estate tax liability of the business by utilizing a Grantor Retained Annuity Trust (GRAT). This optional strategy can significantly reduce the future estate tax liability by selling part or all the equity in the business to a trust in exchange for an annuity payment system, thereby placing the future appreciation of the business outside the grantor's estate. Thus, the GRAT structure freezes the value of the business for estate tax purposes and minimizes future estate taxes. In a similar manner, the optional grantor Charitable Lead Annuity Trust (CLAT) can decrease or offset against ordinary income tax in a given year. The other main income tax offset is an investment into a Qualified Opportunity Zone (QOZ), which is an eligible low-income census tract that is designated QOZ and certified by the Treasury. The governors of all 50 states and Puerto Rico have identified a total of 8,764 QOZs (based on 2010 U.S. Census Bureau data). The QOZ was part of the Tax Cut and Jobs Act of 2017 and has been successful and supported as a bi-partisan initiative as an economic development tool that is designed to spur economic development and job creation in distressed communities. There is a dislocation for the investor here, as the data highlights areas that were distressed in 2010 but may be flourishing in 2021 such as parts of Austin, Denver, and Nashville. In the end, I support the notion of QOZs as a development tool attracting private capital to expand housing needs of a growing population.

What is included in the estate tax? The family business interests, real estate, the single-family office (assets), revocable trust assets (including investment accounts), Roth 401(k), and life insurance death benefit amounts more than the federal exemption amount. What is not included are the DAF, ILIT, 529 college savings account, third party special needs trust, family foundation, and life insurance death benefit proceeds below the federal exemption level. As I mentioned before, revocable trusts in community property states enjoy a double step-up in basis, and it could be beneficial to sell illiquid assets after the first passing for income tax savings then gift percentages of the family LLC (oftentimes the family office) to children at reduced valuations due to lack of marketability and a lack of control, generally a 30% to 40% discount. Unlike the federal rules, there are no lifetime gifting limitations at the state level in Washington which can be important when facing a small exemption amount on the death tax of only $2,193,000 and a top tax rate of 20%. Washington has been chosen as a practical example because I was born in Seattle. In 2021, Governor Jay Inslee proposed a new capital gains tax to his constituency and the Washington Legislature passed ESSB 5096 which created an entirely new 7% capital gains tax for residents. This was significant because, prior to the passage, there has only been a sales tax and business and occupancy tax in Washington. Former Attorney General for the State of Washington, Rob McKenna, along with the Washington Farm Bureau are challenging the constitutionality of the new tax that is slated to be implemented in 2022. This is a local example of additional rising tax liabilities that will have repercussions within the family business community in Washington.

Moving to additional pre-tax options for business families are health savings accounts, flexible spending accounts, and dependent care reimbursement accounts. All of these are recommended for business families, as it is likely a more tax efficient manner of covering healthcare and family expenses that are virtually unavoidable. Paying for health care services and prescriptions on a pre-tax basis will allow a family to almost double the amount of services for the same after-tax dollar spend (depending on the tax bracket of the individual). This can be particularly helpful when used for an array of qualified preventative healthcare services (e.g., chiropractor) and treatments.

Donor Advised Funds and Family Foundations

Many people will utilize a DAF as a tool for their charitable giving, as it also represents a pre-tax opportunity to deploy assets. A DAF is best seen as a compliment to the family foundation. There are lower administrative costs than an operating family foundation, and it can also protect the donor from unwanted publicity through anonymous gifting, if that is desired. Cash giving is limited to 60% of a grantor's adjusted gross income, rather than 30% in family foundations. This is an excellent tool for transferring shares of a family business looking to sell (prior to receiving a letter of intent) and receiving a tax deduction for the full fair market value. It can also be a great tool for transferring shares of highly appreciated publicly traded stocks, exchange traded funds, or mutual funds. Systematic contributions into the DAF allow for dollar cost averaging and the assets are invested in marketable securities within the structure until grants are advised and distributed. This creates an opportunity to earn interest and investment gains prior to grants, thereby increasing the planned giving. The DAF also consolidates the family's annual tax reporting on philanthropic donations, and it can be utilized as a tool to minimize or eliminate the estate tax, depending on how much is contributed.

It is important to distinguish between a DAF and a family foundation. A family foundation is a great tool for building a family legacy and a family 'watering hole' for others to drink from as well. It is a perfect location to involve children and train them for the responsibilities of wealth. The family can appoint the board of directors, and the board has complete control of all grants and investments. Of course, subject to self-dealing rules (e.g., selling or leasing property, lending). The family can employ and pay staff reasonable compensation, including family members and children. If the family wants privacy around a gift, the foundation could grant funds to a DAF and then have the DAF grant anonymously to the recipient. Also, the family can be reimbursed for qualifying foundation expenses, which might include service trips and board meeting expenses. Like the DAF, the family foundation can be utilized to minimize or eliminate the estate tax depending on how much is allocated to it. Again, like a DAF, private credit is an ideal asset class to invest charitable assets for additional tax efficiency and capital preservation of philanthropic funds.

Qualified Retirement Plans

Regarding qualified retirement plans, there are several different opportunities. One distinction worth highlighting is a Roth 401(k) vs. a Roth IRA. Generally speaking, a Roth 401(k) is more favorable than a Roth IRA, although many business owners errantly assume that they make too much income to contribute to a Roth 401(k). For example, someone who is married filing jointly may presume that their ability to contribute to a Roth IRA is phased out around $198,000 per year of joint income. In a Roth 401(k), there is no income restriction on one's ability to contribute. Furthermore, the contribution size is $26,500 if they are 50 or older, vs. only $7,000 into a Roth IRA, almost four times larger.

Another manner to help business families benefit from a 401(k) is a safe-harbor arrangement. In a safe-harbor matching arrangement, the business offers a 4% match to the employees which exempts the plan from top heavy, actual deferral percentage and actual contribution percentage tests at the end of the year. These calculations are intended to ensure that 401(k) plans do not unfairly benefit highly paid employees at the expense of others. Although these tests would historically limit owners and executives from being able to make their full maximum deferrals into the plan, the safe-harbor arrangement opens those doors for all owners and executives while providing a match that they benefit from as well. Furthermore, if automatic enrollment provisions are integrated into a retirement plan, the IRS provides an additional tax credit to the employer.

Built within the 401(k) plan, typically there is a discretionary profit-sharing formula which can weigh the benefits towards the owners in a non-pro rata fashion. Prior to age 59 ½, owners can access their defined contribution plans assets through loans of up to $50,000 per person. It is also possible to integrate alternative assets inside of the 401(k) plan through a self-directed brokerage account window, which can allow for use of private credit or other investment opportunities.

At the end of the spectrum of qualified retirement plans is a cash balance plan, which can provide tax deferral on as much as $230,000 per year. Many people do not understand the maximum extent of tax savings allowable under law on a qualified basis with a cash balance defined benefit plan. However, these plans are ideal for smaller, highly profitable businesses with a stabilized and mature cash flow (e.g., dentists, law firms). Overall, qualified retirement plans are an exceptional location for tax deferred retirement income and asset protection. Employer-sponsored qualified retirement plan assets are protected from claims of creditors both in and out of bankruptcy actions under the Employee Retirement Income Security Act of 1974 (ERISA), which also overrides any state laws that appear to allow creditors to reach retirement plan assets. Finally, a single-family office is an ideal place for a qualified retirement plan as there are no businesses too small to be precluded from enjoying the tax benefits.

Real Estate

Next, I move from the pre-tax through the income tax to a standard account bucket. Keep in mind that in California a top tax rate is going to be around 51% for both federal and state. Within the standard bucket, I recommend real estate as the dominant asset class due to the numerous tax benefits associated with real estate (e.g., 1031 exchange, step-up in basis, tax-free cash out refinance, cost-segregation depreciation). One of the best tax benefits of real estate is the 1031 tax free exchange. The 1031 exchange allows a real estate investor who has an appreciated property to sell the property and exchange it for a like property with the same amount or more debt attached to that property. This maneuver exempts them from a capital gains tax and allows them to roll the taxable gain down the road. Keep in mind that because of the step up in basis, if they keep rolling that down the road until the first spouse dies and the asset is held inside a trust, there is a step up on the tax basis and there would be no income tax due on the gains. This is one of the golden opportunities of real estate within cross generational financial planning. An additional advantage of real estate is cost segregation depreciation. Real estate represents an investment that you get to depreciate while it typically increases in value, and cost-segregation studies can shorten the depreciation time for taxation purposes, reducing current income tax obligations.

Part of the tax benefits around real estate are predicated on the government's support and need for real estate development by the private sector due to the housing needs of a growing population. The government is not in the business of real estate development. Because of this, the multi-family real estate development must come from the private sector. For it to happen through the private sector, the only way that Congress can incentivize the populace is through tax deductions and tax credits.

With real estate, depreciation rules allow you to depreciate an asset that is increasing in value. An investor can also take cash out of that investment through a tax free, cash out refinance. While the asset stays in effect, the investor can borrow money out of that asset and it is a tax-free event. Also, many families will utilize vacation properties, Airbnb, small multifamily, or industrial commercial real estate in favorite family locations. This allows for some of the travel expenses to be deemed as business related and therefore deductible.

Another beneficial aspect of real estate is that a qualified real estate professional designation allows you to accelerate the depreciation and offset losses against active vs. passive income. If there is a professional real estate designation, there is really no limit there. Typically, a business family will establish a real estate management company (family office LLC) and the non-business spouse will take on a designation of real estate professional by spending at least 750 hours or more per year in the real property business in vacation rentals. The single-family office is often the hub of real estate activity for the family and an ideal place to train the children on the responsibilities of tangible asset management. The family LLC works well for discounted gifting and for estate tax planning purposes through a lack of marketability and a lack of control.

Private Placement Life Insurance and Cash Value Life Insurance

Next, I move on to the fourth key ingredient of the Reverse Endowment Model. Normally, we see cash value life insurance structured in a business family as an after-tax Section 162 Executive Bonus Plan. This is a deduction to the corporation as a wage, and oftentimes there is a double bonus to cover the tax liability of the arrangement to the executive. The funds are earmarked and put inside of a life insurance policy to grow on a tax free or tax deferred basis. Generally, the insurance policy is an indexed universal life, a whole life, or a variable universal life policy. A Section 162 Plan is utilized to grow the after-tax bucket along with maximizing the Roth 401(k) and pre-tax qualified retirement plans (including profit sharing or cash balance). One thing to consider is that life insurance is a self-completing plan versus a traditional savings arrangement. By self-completing plan I mean that if you had a $1M death benefit on a life insurance policy and you juxtaposed it against a target funding of a standard investment account, you would save $1M. If you fund both an investment account and a cash value life insurance policy on a regular continuous basis for $2,000 a month in a standard account, after one year you would have $24,000 (before any gains or losses). In the life insurance policy, you might have only $20,000 due to insurance and M&E costs. There is a bit of insurance drag there in cost, but if the individual dies after the first year with the standard account you would only have approximately $24,000 of the target $1M savings goal. In the life insurance scenario, it completes the plan for the family and injects a million dollars income tax free to the family, thereby safeguarding the family members.

An indexed universal life policy can be an incubator for after tax investment assets and can be exchanged for a PPLI policy down the road with no tax consequences through a 1035 exchange. A 1035 exchange in life insurance is like a 1031 exchange in real estate, whereby the investor can swap real property for real property and avoid tax in that transfer. Life insurance also affords a similar tax-free exchange, which allows you to take an underperforming variable universal life or whole life policy and exchange it into a different type of policy, perhaps a PPLI, or an indexed universal life policy without having to pay any taxes.

Cycling back to the indexed universal life, some policies now have an option called a planned giving rider that commits an additional 1% of the death benefit to the owner's charity of choice from the life insurance company. This is a stroke of generosity on behalf of the insurance carrier and I applaud the executives responsible for making the planned giving rider available.

A PPLI policy is technically a type of variable universal life (VUL) privately negotiated at the institutional pricing level. A PPLI contract is an upgrade from a retail VUL policy or possibly even an indexed universal life (IUL) policy in my opinion because the policyholder can have private equity as an engine for long term growth within the policy. This may be an upgrade for an indexed universal life policy if the indexed universal life insurance carrier has reduced the caps and participation rates on the underlying index investment options. Private equity has historically been the highest performing asset class over the long run. There are no K-1 tax reporting requirements on private equity inside of a PPLI structure, as it is wrapped inside the policy. This makes it easier for investors that are used to waiting for their K-1s and are stuck filing their personal taxes in the fall. The institutional pricing for the PPLI arrangement is predicated on a minimum commitment of $3M (oftentimes more), that would be funded over two to five years in a non-MEC arrangement.

A premium holding tank (earmarked investment account for capital calls and premium commitments) is utilized within the revocable trust for the PPLI premium commitments to hold those assets while waiting for them to be deployed in subsequent years. A hallmark of the Reverse Endowment Model is the underlying asset protection combined with asset control. Both qualified plans and life insurance enjoy asset protection and asset control without having to go offshore. When someone opens a life insurance policy or a qualified retirement plan and they put money in, those assets are protected from creditors depending on the jurisdiction of the claim. In Washington, there is unlimited protection from creditors on cash value in a life insurance policy, and we see protection from creditors in all qualified plans from the federal level.

Furthermore, the IUL or the PPLI arrangement can provide supplemental tax-free retirement income to fulfill goals during lifetime through withdrawals of basis and loans. You can see income coming to the parents from multiple sources: one from the retirement income on the IRA, one from the Roth 401(k), one from the real estate income, and then one from the life insurance withdrawal basis.

The beneficiary designation percentages of the PPLI policy can be adjusted at any time while the policy is in force. The annual family foundation meeting can be a time to not only discuss philanthropic grants and initiatives, but it can also be constructively used to minimize the family's estate tax liability by adjusting the policy beneficiary percentages to match the federal exemption amount to the dynasty trust while allocating the remainder to the family foundation for a generosity and planned giving factor. This is one of the beneficial elements of the Reverse Endowment Model to the general population, as it can provide significant capital to non-profit organizations and reduce the family estate tax liability simultaneously. For example, in 2021, a policyholder might allocate $23.4M of the death benefit to the dynasty trust and the remaining amount to the family foundation. Utilizing family foundations or non-profits as named beneficiaries of a permanent life insurance policy is an age-old planned giving technique that creates a leveraged asset transfer. Keep in mind that estate and income tax rates have varied wildly on a historical basis, and I would expect the tax rates to be erratic over the next 40 years. Therefore, it is critical for the HNW family to maintain dynamic control of their assets during their lifetime, in case their circumstances change. With UHNW, the PPLI assets are generally considered shelf money, whereby they never intend on needing or touching the principal or income. This investment position is better suited for having the policy structured within an irrevocable dynasty trust from the beginning to grow well past the federal exemption amount. In our time series analysis, this would be reflected in the second-generation construct.

Whether or not a family decides to name their family foundation as the beneficiary can also be predicated on the children's responsibility or engagement. From an estate tax minimization approach either a family foundation, DAF, or direct charity can all be utilized to enhance planned giving while simultaneously zeroing out a family's estate tax liability. Which structure to choose has to do mostly with a children's level of responsibility and engagement. If the children are actively and responsibly involved in the family foundation, or are well prepared as heirs, then naming the family foundation as the beneficiary is ideal. If the children are at a medium level of responsibility and engagement, then I recommend the DAF, which would have less responsibilities for the children, but still give them the ability to direct where grants could be advised for other qualified charities. Last, if there is a low level of responsibility or engagement on behalf of the children, I would recommend naming a charity that aligns with the parent's philanthropic intent and planned giving desires that could be changed each year again at the annual foundation meeting or family meeting.

Dynasty Trusts and the Family Bank

A dynasty trust is a trust designed to minimize estate taxes being applied to the family assets at each generation. By definition, a dynasty trust can run into perpetuity and must be created in a state that has no rule against perpetuities such as Delaware, Alaska, or South Dakota. Although Wyoming, a favorite locale of UHNW, has a rule against perpetuities, they still allow for 1,000 years and Nevada allows for 365 years. By holding assets in the trust and making clearly defined distributions at each generation, the family assets in the trust are not subject to estate, gift, or generation skipping taxes. The Reverse Endowment Model utilizes South Dakota as a jurisdiction of choice because their trust laws have no rule against perpetuities, they have one of the lowest premium tax regimes in the nation, and death benefits (and sometimes premiums) have a measure of flexibility allowing in-kind death claim payments which make it much easier for the practitioner to utilize less liquid alternative assets in the underlying separately managed account (SMA) or insurance dedicated fund (IDF) within the insurance policy. The first-generation structure of the Reverse Endowment Model utilizes a South Dakota

LLC as the owner of the PPLI policy. In the second generation, I would recommend a South Dakota trust to be the owner of a South Dakota LLC, which would in turn own the PPLI policy.

A family bank is a concept that can be remarkably useful for affluent families to perpetuate wealth and maintain family harmony. A family bank is an entity (oftentimes a trust) that provides an organized process and structure for funding from family members to family members. Rather than giving large amounts of money directly to the children, a family bank can be established with the purpose of loaning money to the family members in order to make the children more successful and independent. The children, or other family members, apply by submitting a request with a formal business plan and ask for either a loan or a direct equity investment (structured much like an unsecured mezzanine loan with a warrant). The process of writing a thorough business plan and submitting it to the family or board of family advisors for approval undoubtedly sharpens the child's vision for the resources versus a large outright gift. This structure creates significant upside opportunity for those who desire it.

Intra-family loans can also be utilized by the second and third generations to access family wealth within and without the structure and are part of the reason I consider deploying a family bank concept. Intra-family loans are loans between related parties. These loans often utilize the applicable federal rate (AFR) in accordance with Section 1274(d) of the Internal Revenue Code. The historically low rates provide the opportunity for children or other family members to finance major purchases at a more advantageous interest rate than a commercial bank. Further, it can be quite beneficial for buying into the family business or a first home. The assets stay within the family and typical commercial lending closing costs of a loan are eliminated. The loans provide a way to get targeted capital to the children while aiming to preserve the child's self-sufficiency and to learn about the intelligent and responsible use of credit. If a family transfers an asset at its current or discounted value to an irrevocable trust, such as an intentionally defective grantor trust or grantor retained annuity trust for the consideration of a loan or annuity payment, it will allow the asset's higher growth rate (than the AFR) to occur outside the taxable estate. This technique is often deployed within families that own private companies as a cross-generational planning tool.

A dynasty trust is a long-term arrangement and, because it is an irrevocable trust, the assets are removed from the owner's estate. This shields the assets from creditors and lawsuits and keeps the assets from being eroded by estate taxes. However, a dynasty trust has little to no flexibility once it is irrevocably established and no changes can be made to the trust document. The Milton Hershey case is a great example of the unchanging nature of trust language and why a trust requires thoughtful selection of both the language and trustee. A trustee of a dynasty trust has the fiduciary responsibility and duties of administration, accounting, investment management, and safeguarding the trust estate with a duty of care. However, if a trust is going to last for many years, a trust protector is recommended and may allow a trust to be more flexible to future law changes. A trust protector is typically appointed by the settlor of the trust at the same time as the trustees. Essentially, it is a check and balance on the trustee. If the trustee is not serving the needs of the beneficiaries, the trust protector can step in and remove the trustee. In recent history, trust protectors were utilized more frequently in offshore accounts; however, South Dakota as a bellwether trust state has codified the role of trust protector:

> Any governing instrument providing for a trust advisor or trust protector may also provide such trust advisor or trust protector with some, none, or all of the rights, powers, privileges, benefits, immunities, or authorities available to a trustee under South Dakota law or under the governing instrument. Unless the governing instrument provides

> otherwise, a trust advisor or trust protector has no greater liability to any person than would a trustee holding or benefiting from the rights, powers, privileges, benefits, immunities, or authority provided or allowed by the governing instrument to such trust advisor or trust protector. (South Dakota Legislature, 55-1B-1.1.)

South Dakota's statutes on trust protectors gives practitioners and families clear insights on what can and cannot be done. Specifically, a trust protector can approve changes in the language of the trust document, fire or remove a trustee, terminate a trust, adjust distributions based on the beneficiary's lives, and add or remove beneficiaries. It is the language in the trust document that gives the trust protector the authority over what they can or cannot do. In addition to the trust protector, you can have the trust language structured whereby the beneficiaries have the power to fire and replace the trustee according to voting thresholds set forth in the trust documents. This language in the document can help protect the beneficiaries that find themselves in an abusive trustee situation. Essentially, the beneficiaries can cross check and vote in agreement to make sure that their trustee is acting in the express interest of all beneficiaries.

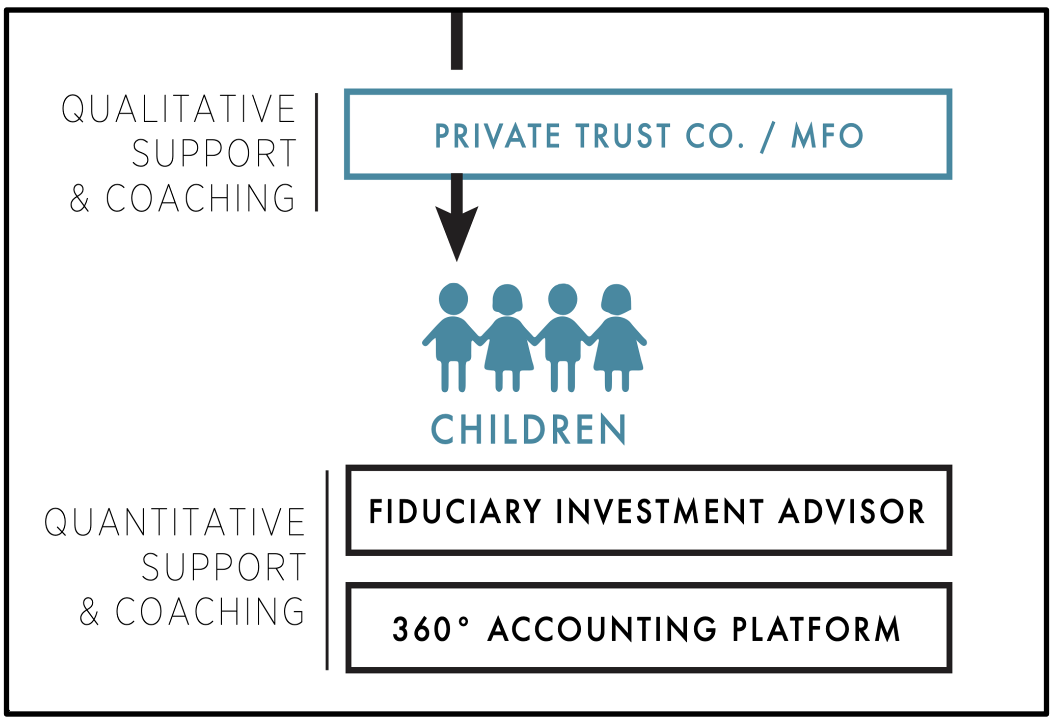
The federal estate tax is a tax on your right to transfer your property. A long-term family trust with cross generational provisions exempts the need to transfer the assets at each generation and trigger estate taxes. However, to avoid entitlement and over-consumption of the beneficiaries, this pool of capital intended for the long-term benefit of the family members needs to be carefully structured. Significant wealth is a tremendous responsibility and can be used for the building up of a family and its planned giving and sometimes the weight of it can be self-destructive or demotivating to a recipient. In a positive context, a family bank might consider making loans or distributions to help family members buy their first home in a safe neighborhood. It could lend money to them for seed capital to buy a business or develop real estate. Family funds could be used to cover any medical emergencies or pay for concierge or preventative medicine. It could cover the ongoing property taxes and maintenance on family vacation properties and residences. The trust can provide retirement income streams for family members as they enter their golden years of retirement, thereby buttressing retirement security among all family members as they age. The trust could pay all family and travel expenses for an annual or bi-annual family gathering in an enjoyable location. These are some of the main areas that we see qualitative distributions of dynasty trust assets to enhance and support the health and the relationships of the family. From a succession planning perspective, it is important to understand that among wealthy families, generally there is a breakdown of wealth within three generations, specifically within business families. According to Preisser and Williams (2010), the research would anecdotally point to a breakdown of trust and communication as the greatest threat to the wealth of the family. Ironically, the greatest threat is usually from within, not from the outside, which is why I would prioritize the overall family relationships and physical health in the distribution of wealth. In one respect, these distributions can be seen as a long-term investment versus a short-term expense.

In the Reverse Endowment Model, I start with the end goal in mind of having the beneficiaries surrounded with both qualitative and quantitative supporting structures. The qualitative supporting structure is reflected by a private trust company arrangement whereby the trustees or trust protectors are involved in the coaching and mentoring of beneficiaries in accordance with the values and philosophies espoused in the trust documents. The quantitative supporting structures are twofold: an accounting platform or team that provides 360-degree perspective on all family businesses, investments, cash, and capital flows across the entire family balance sheet and a fiduciary investment advisor. I suggest a fiduciary investment advisor that has a fiduciary relationship with the family or the single-family office as opposed to a broker/dealer that gets paid commissions.

This surrounds the children with both quantitative and qualitative elements, knowing that only 3% of the breakdown in wealth is generally attributed to quantitative mistakes whereas 97% of the breakdown in family business wealth is associated with qualitative concerns (Preisser & Williams, 2010). Supporting them in both these areas is critical in my opinion as a practitioner. Figure 4 highlights this.

Figure 4

Coaching Beneficiaries in the Reverse Endowment Model



Irrevocable Life Insurance Trusts

For assets held outside of the dynasty trust, an irrevocable life insurance trust (ILIT) can work to pay the estate taxes on real estate or other illiquid assets, along with paying off the existing loan balances on family properties to enhance the cash flow in this asset swap. The purpose is to create liquidity for the estate tax liability on illiquid family assets and investments, mainly the real estate and the family businesses held inside the revocable trust. This is seen by practitioners as one of the most effective, efficient, and least costly manners to cover estate tax costs. By purchasing the life insurance policy outside the estate with a systematic program of lifetime gifts, it minimizes the estate tax by keeping the (usually significant) death benefit proceeds outside the taxable estate while minimally reducing the estate size by the systematic gifts to pay the insurance premiums.

Having liquid funds available to pay the estate tax on large illiquid family holdings (such as a family business or apartment building) protects the inheritor's from having to liquidate assets or businesses to cover the corresponding estate tax due. Essentially, the ILIT purchases the business or real estate from the estate for cash, and the cash is used to pay the estate taxes. The illiquid assets would be distributed tax-free according to the ILIT terms. A second approach is for the ILIT to negotiate a short-term loan from the trust to the estate's heirs at an interest rate equal to the AFR mentioned earlier to cover the estate taxes due on the illiquid assets.

The additional purpose of ILITs for business families is for estate equalization among children that are managing specific family businesses, versus those who are not involved in the day-to-day management of those enterprises. Most parents would like to leave proportionate assets to their children, but how do you accomplish that if the family business makes up most of the family's wealth? Imagine if someone had three children, one of them worked in the business and two did not. Oftentimes, a family will want to leave the business to the child that works in it, but they usually want to equalize the inheritance with cash or real estate to the other children who are not active in the business. By utilizing a life insurance policy inside an ILIT, the parents can use life insurance planning on both an income and estate tax free basis to equalize the anticipated inheritance dollar value across all three children. I call this estate equalization planning, utilizing an ILIT and a permanent life insurance policy.

The Reverse Endowment Model emphasizes the tax advantages of building a family real estate portfolio and training the children on the responsibilities of wealth through the lens of investment property management and improvements. One consideration for families with real estate portfolios is for ILIT funds to not only generate the liquidity necessary to pay the estate taxes on illiquid assets, but also to pay off all family real estate portfolio property loans, including vacation properties, thereby significantly bolstering the net income on the underlying real estate investment portfolio for the next generation. Real estate is one of the preferred investments to transfer to children, as it can be much more difficult to self-destruct an inherited portfolio of less liquid real properties that have positive cash flow than it is to spend through an inherited liquid brokerage account.

The federal estate tax is due in cash within nine months of death, which can be a short period of time to sell an illiquid asset and may subject the seller to an unfavorable market. An ILIT provides a structure whereby a permanent life insurance policy can be purchased by the trust through a systematic gifting schedule that is usually within the annual federal gift tax exclusion amount. When the grantor/insured passes, the death benefit proceeds are made available for the ILIT to loan to the estate or to purchase assets from the estate for cash, providing the estate with the funds necessary to pay estate taxes and estate settlement costs.

Private Equity and Alternative Assets

The final key ingredient of the Reverse Endowment Model is private equity, which represents one of the highest performing asset classes over the long run. The three most important types of private equity investments in relation to the REM are primaries, which generally produce the highest returns, secondaries, which are buying existing primary funds at a discount, and co-investments, which often represent the best risk adjusted return.

At the crux of understanding private equity is the illiquidity premium, which is a term to describe the additional return anticipated by investors on investments that cannot be converted to cash easily. In most traditional and institutional private equity fund arrangements, the investor is focused on the highest return over a long-term period. Hence, institutions and endowments are consumers of these less liquid constructs which are generally an 11 year commitment. For example, at the time of this writing, KKR who is arguably the grandfather of all private equity firms, boasts an average net return to their investors over a 44-year period of 19.3%.

When an investor has a long-term investment horizon, it is more advisable to focus on the merits of the underlying investment and the corresponding returns rather than overvaluing short-term liquidity opportunities. This allows the underlying manager to invest in businesses and allows for enough time to enhance the value of the enterprise prior to selling the business and redistributing profits and capital back to the investors. Initially, the private equity managers deploy capital into the businesses to purchase, then fix and flip (much like real estate). This creates a J-curve effect on the investment value with a trendline that reflects an initial loss immediately followed by a sharp gain.

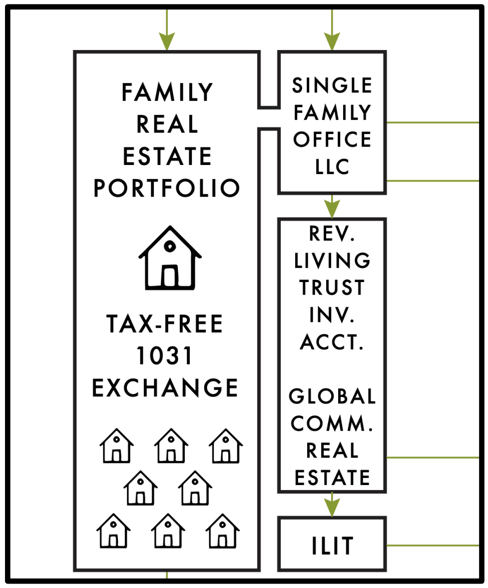
The Single Family Office and the New Virtual Family Office

The single-family office is usually connected to the family real estate portfolio. Oftentimes, the family office is an LLC and the positive cash flow from the family's real estate portfolio can be directed into the single-family office to provide additional offsetting legitimate business expenses prior to providing the parents with a stable income stream during their lifetime. In relation to the Reverse Endowment Model, the goal of the parents is a stable lifetime income that is mindful of asset protection and tax minimization. These are common goals among business owners and first-generation wealth creators.

The single-family office is an ideal location for managing real estate, involving children in wealth management, and the application of the Reverse Endowment Model as can be seen in Figure 5. My definition of a single family office is a corporate entity and formal organization oftentimes staffed with non-family employees that historically provides services such as day-to-day accounting and payroll activities, management of legal affairs, family management services, which includes family governance, financial and investment education, philanthropy coordination, succession planning, property management, managing household staff, making travel arrangements, and managing investments and trusts for a single family. A family office can cost over $1M a year to operate, so the family's net worth usually exceeds $100M in investable assets. In general, a single-family office serves between 4-6 households and is staffed with 8-11 professionals. In practice, there is a common understanding that a single-family office is an organization that serves multiple households across one or more generations that are bound together by family ties. The single-family office can be juxtaposed against a MFO or a PFO. MFOs and PFOs are usually banks, brokers, or investment firms serving multiple families and organizing their investments on a family balance sheet basis. This is historically much different than a single-family office, whose thinking and worldview are more closely associated with an operating family business that has sold. A single-family office is culturally different from most MFOs or PFOs and can reflect a more relaxed and informal office culture.

Figure 5

Income Flow Example in the Reverse Endowment Model



In 2020, due to the impact of COVID-19, practitioners have seen the rise of what I coin the virtual family office (VFO). The rise of the VFO is more significant than people may recognize as it builds on the shortcomings of the MFO. The goal of the MFO is to provide a single point of contact for the family across the entire balance sheet by providing thoughtful and intelligent advisors and investment managers. This suite of professionals generally covers the spectrum of investment management, tax compliance/preparation, tax planning, estate planning, legal services, risk management/insurance, financial planning, succession planning, and family governance consulting. Keep in mind that most of these duties relate to the quantitative aspects of family wealth management and can be executed by private client divisions of banks and investment firms. However, each of these areas involve human beings that may or may not be a good fit with the family from a worldview or cultural perspective. An MFO typically has the suite of professionals in-house, and although few people would recognize it, severely limits the professional to the current roster of those employed by the MFO.

A VFO is similar in operation to the MFO but is far less constrained (virtually unlimited) in the underlying talent pool of professional advisors and consultants. Historically, an MFO would meet with a client at a specified location with geographical constraints on the clients and advisors. Nowadays, it is easier than ever to assemble a top cast of professional advisors, each independently at the top of their profession across different firms, by utilizing Zoom or other virtual technologies to conduct collaborative meetings with the family (and among the advisors) on a much more frequent basis. This ensures greater alignment between the family and the advisors, as well as among the advisors to move cohesively to support the family.

Evolution of the Reverse Endowment Model

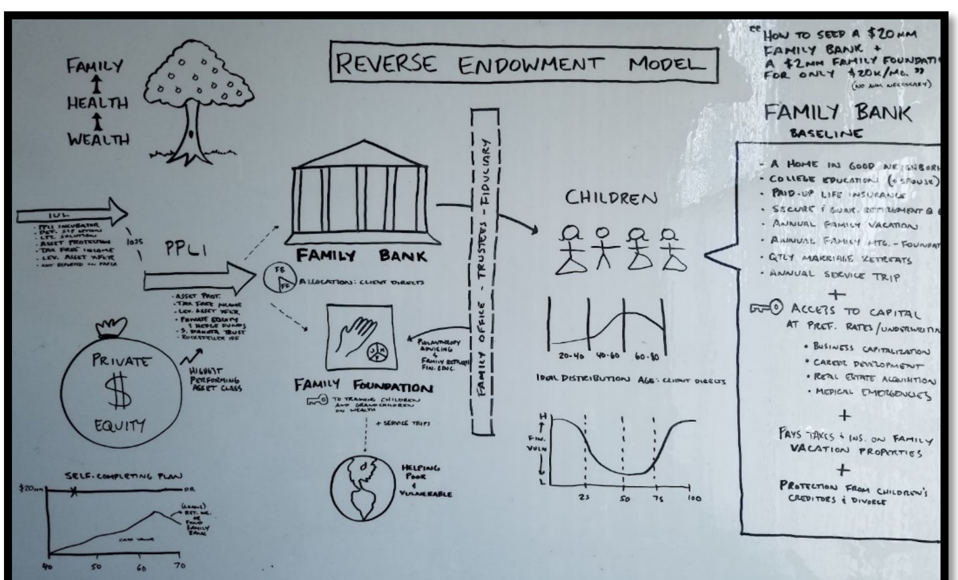
Prior to conducting this research, I was reminiscing on the combination of private equity, life insurance, and family foundations. I had a hunch that there might be an opportunity to combine those elements in a manner that could possibly create an oversized social impact while simultaneously providing for the family's needs during their lifetime. I hypothesized that the integration of these elements was synergistic, which was the foundation of the research. Furthermore, I was curious if I could reverse engineer an endowment for the first generation of wealth creation by utilizing a series of life insurance premium payments of $20,000 per month to create a $20 million family bank and a $2 million foundation. I used a theory of leveraged asset transfer through the utilization of permanent life insurance. In my mind, this was the driving force for the amplification of wealth; however, I needed an investment vehicle within the life insurance policy that could have the opportunity to generate much higher investment returns than fixed income. A diversified private equity approach was chosen as the underlying investment vehicle, but that necessitated the use of a PPLI policy. Just prior to starting the research, the Tax

Cut and Jobs Act of 2017 raised the federal estate exemption amounts which created more capacity for families to keep on their balance sheets prior to taxation.

My first draft of the Reverse Endowment Model was very simplistic and mainly focused on private equity, life insurance, and the family foundation. It was more philosophical in nature, as it touched upon the ideal ages to transfer wealth to children and highlighted the financial vulnerability levels of various ages. I was focused on the priority of wealth being subordinated to the family's health and relationships. The role of a multi-family office or trustees to guide the qualitative aspects of wealth was clear in the initial model design. Finally, life insurance was positioned as a self-completing financial plan for the family with opportunities to upgrade existing life insurance policies to a private placement chassis through the utilization of a tax-free 1035 exchange. Please see the initial model below, as it is much simpler and rudimentary than the final Reverse Endowment Model.

Figure 6

Initial Framework of the Reverse Endowment Model



In the beginning of the research, I had a notion of aligning the beneficial pairing of asset allocation with asset location. The asset location discussion is important once one understands the various tax rates of different structures. For example, a Roth IRA is an account whereby the principal amount has already been taxed and the future gains are tax free. A traditional IRA is taxed on a progressive tax schedule as ordinary income, and a standard account would be taxed as either short/long term capital gains. This means that the taxability of the underlying account investments is a significant variable regarding the net after tax distributions. It made sense to take the initial step of aligning the most tax inefficient investments within the ideal structure. However, it must also be understood that different asset classes perform differently and should be utilized in accordance with the investment policy statement. At the practitioner level, I had an assumption of this, but did not realize how important the math is behind asset location. This predisposition was also predicated on the current limitations on contributions to IRA or Roth IRA/401(k) accounts. Utilizing PPLI and dynasty trusts allowed for the beneficial elements of asset location to be expanded to the HNW demographic using additional planning tools with different funding guidelines and IRS limitations. Understanding how different asset classes (i.e., real estate, credit, equity) are assessed taxation is critical to understanding the beneficial elements of asset location. This led to the initial concept of placing the credit in the pre-tax bucket due to interest being taxed as ordinary income and placing equities in a Roth IRA/401(k) or accessing private equity through a long-term planning arrangement utilizing PPLI. The placement of equity (public/private) into a PPLI policy allows for the growth of the equity in a more tax favored manner for the long-term. Real estate enjoys significant tax benefits and is best utilized in a standard after tax account to maximize the existing beneficial tax elements. Keep in mind that real estate tax benefits are to incentivize investment into real estate, therefore maintaining pace with societal housing needs and providing employment opportunities for those involved in the development process.

Once I had the initial pieces laid out in the model, I realized that there is always a tug of war between income taxes and estate taxes when it comes to cross-generational planned giving. I thought it would be helpful to demonstrate the tension with a vertical line for the income tax and a horizontal line for the estate tax. This model immediately made sense as I began to draw and display the movement of capital through the diagram. Further, it gave visibility to the opportunities for planned giving utilizing a DAF and a family foundation. I realized that the DAF would be an ideal recipient of an overfunded and unspent retirement account, after the death of the surviving spouse. I also wanted to test the viability of utilizing the family foundation for the federal estate tax exemption amount as a beneficiary on the PPLI policy (that could be adjusted at any time). Most cross-generational planning involves irrevocable trusts that are difficult to modify as the tax laws change, whereas this model seemed to maintain flexibility and control for the business family that is needed and desired for the HNW demographic.

Throughout the course of research, I understood the beneficial elements of intra-family loans as a tool to provide tax advantaged loans to family members that may be utilized for several purposes (e.g., starting a business). I also learned about optional components to the model such as a CLAT and a GRAT.

In the end, the visual display of the Reverse Endowment Model that was created allowed me to visually map and integrate the various tools available for long-term planned giving. I built the corresponding case study as a financial plan to integrate the various components of the Reverse Endowment Model and demonstrate the empirical results. Both the time series and sensitivity analyses are verifiable and based on observations rather than theory or pure logic.

Implications for Business Practice

Based on the survey results, there seems to be an unrealized market opportunity for both insurance carriers and alternative asset managers in respect to PPLI among the HNW demographic. Market equilibrium between supply and demand has not been established yet. Although someone can invest in private equity if they are an accredited investor, the nature of the construct with $3M being the smallest placement requires that the investor be a qualified purchaser. A qualified purchaser can be either an individual or a family-owned company that owns at least $5M in investments. Typically, HNW is described as a range between $1M-$30M of assets, so a large part of the HNW demographic would be considered a qualified purchaser by definition. It would be difficult to have a $3M investment in PPLI for a family with less than $5M of net worth in a suitable manner.

According to the survey results of this dissertation, there seems to be an asymmetry of knowledge between UHNW and HNW, and their advisors, as it pertains to asset protection, tax planning, and wealth management techniques. This may be why many HNW have not heard of PPLI as a planning tool. This may also be explained by not benefiting from the coordinated efforts of a single-family office, whereas most HNW do not participate in a multi-family office and do not have sufficient assets to justify a single-family office. Offshore PPLI insurance providers in Bermuda and the Cayman Islands are hindered by regulation from marketing their policies in the U.S., which may be another reason why many HNW have not heard of PPLI.

Globally, the wealthiest are increasing their allocations to alternative investments such as private equity, real estate, and private credit (Amit, 2018). The U.S. Private Equity Index has outperformed the S&P 500 for the last 25 years with less volatility. As of December 31, 2018, the U.S. Private Equity Index averaged 13.21%, while the S&P 500 Index averaged 9.07% over the same 25 year period. The long-term investment construct of a PPLI arrangement is an ideal asset location for private equity as one of the best performing asset classes. The long-term nature of PPLI pairs well with the long-term commitment and growth profile of private equity.

The financially sophisticated are the only demographic in the US whereby the number of life insurance policies that are sold each year are increasing. Every other category has been steadily declining, excluding group life insurance (Mulholland et al., 2015). The 2017 Tax Cut & Jobs Act raised the estate tax exemption amount which could make HNW families consider structuring a PPLI policy in a fundamentally different way than most traditional PPLI policies are constructed to take advantage of the higher exemptions.

Why is the PPLI conversation important for business families and their advisors? The reason that I am focusing my research related to business families is because of the complexity of planning that is necessary to increase their family wealth and their planned giving. With more than 27 million privately held businesses in the US, business owners make up much of the economic fabric of the country and can have tremendous social impact. Entrepreneurship and philanthropy are woven together in a cycle of wealth creation and planned giving.

Business families with a focus on planned giving might be drawn to the oversized philanthropic impact of the Reverse Endowment Model. Generally, business owners are more comfortable with alternative assets, especially private equity as it represents the same pathway to wealth creation that often propelled them into their socio-economic status. Further, this demographic seems to appreciate advanced planning and asset structuring, as our survey indicated. Many of these families are avid supporters of non-profits and educational institutions and may find the idea attractive of a major investment into non-profit organizations that address social problems in their immediate communities. For example, consider if a local food bank and supporting organizations received a grant of $68M. It would provide the funding necessary to create local transformation if managed and distributed intelligently. The time series analysis of the Reverse Endowment Model is intended for a main street business owner, most likely in a post-liquidity event time period (directly after completing the sale of their family business). The oversized allocation to philanthropy allows the wealth holder to zero out the estate and income tax liabilities associated with a non-MEC (PPLI policy) by coupling a distribution of the life insurance death benefit between the family foundation and the family bank (dynasty trust structure in South Dakota). Under this arrangement, the longer that someone lives, the account value in the PPLI will keep growing and thereby increase the amount earmarked for charity as the excess amount above the federal estate exemption limit.

In the simulation presented in this research, at age 84 this resulted in $68M future dollars going towards planned giving and $23.4M seeding a family bank. The non-MEC structure allows the policyholder to adjust the named beneficiary on the PPLI policy as often as desired. Practically speaking, this would be addressed annually at a family retreat or family foundation meeting to find the most alignment with the ever-changing philanthropic goals of a family. Further, the beneficiary adjustment can take into consideration the current federal exemption limit on an annual basis and discuss the array of planning options available to the family while adjusting the beneficiary allocations each year. The thought process here is that business owners typically would prefer the control of their funds and ability to make changes to beneficiaries, also the federal estate exemption amount changes like the wind with more or less favorable gusts blowing from time to time. It is difficult to predict today what the federal estate tax rate will be 20 years in the future (most likely higher), if there will be an estate tax (highly likely), or what the exemption amount will look like (perhaps lower than the current exemption amount). In the end, I am hopeful that the quantitative benefits and tax alpha associated with the Reverse Endowment Model will instigate curiosity around the qualitative elements of wealth in families. The latter is centered in philosophy and will be discussed more outside of this research project.

One of the other reasons why business owners were chosen as a potential market segment of the Reverse Endowment Model is due to their outsized role in supporting local, state, and the federal governments under a progressive tax structure. A progressive tax imposes a greater tax rate on taxpayers who have higher income. Essentially, the tax rate increases as the taxable amount increases. It is deemed a progressive tax structure because the tax rate progresses from low to high as one makes more income. For example, the income tax rate in 2021 for a single person earning $40,000 per year is only 12% on federal income tax (on the income between $9,876 to $40,125), whereas an individual making $1,000,000 per year pays 37% federal income tax (on the income over $518,401), plus an additional 3.8% (net investment income tax), plus a state income tax (example 13% in CA), plus payroll taxes. If they are a business owner, they will also likely be paying federal and state income tax on their business earnings, plus a business and occupancy tax at the state and local levels, worker's compensation and unemployment taxes, property tax on their real estate, capital gains tax on their investments, sales tax, and eventually an estate tax at the state and federal levels. Said another way, the amount of revenue collected from business owners by various governments is significant and often represents more than 50% of their income or profits when added together. In a progressive tax structure, this means that business families pay much more than others to uphold these institutions. This is contrary to current sentiment on the news which seems to espouse that business families somehow do not pay a fair share of taxes. Fair seems to be used subjectively, as one might suggest that a progressive tax structure is not fair. However, I will leave that discussion to the philosophers.

From a business practice perspective, it seems that many who are not UHNW do not understand the array of alternative investment options available to them. Family offices of the ultra-wealthy regularly invest in alternative assets that are less correlated to the public equity markets. Upper-quartile alternative asset managers have historically managed assets for the largest pensions, endowments, and sovereign wealth funds. Common alternative investments are private equity, global real estate, private credit, energy, and hedge funds. Technology has allowed for much smaller minimums and increased liquidity for interested investors in alternative assets. Furthermore, access points have been created through various RIAs to the elite alternative asset managers in NYC, London, Hong Kong, and Singapore.

Although PPLI contracts have historically been the darling of families with a net worth of more than $30M, the tax benefits can be enjoyed by families with $5M or more. The adoption of the concept and streamlined technology has allowed it to move from the UHNW to include the HNW population. HNW families that have cross-generational wealth ambitions for their children and a desire for planned giving are a highly suitable demographic for a PPLI policy, according to the results of the current survey. Furthermore, the higher estate tax exemption thresholds ($22.8M for a married couple in 2019) provided by the 2017 Tax Cut and Jobs Act create opportunities for HNW families without the administrative burden of complex trust structures. From an asset location perspective, placing the highest performing assets inside a PPLI contract can create significant tax alpha for the individual. Tax alpha can be described as the outperformance that an investor can achieve by taking advantage of all the available tax-savings strategies. This was the genesis of the PPLI contract but should be expanded beyond hedge funds and private credit to private equity alternative asset managers as private equity represents one of the highest performing asset classes historically. Although liquidity constraints have made it challenging as an asset class within the PPLI structure, modernization and technology are making private equity more accessible within such a policy construct today.

The unrealized market opportunity is apparent as the HNW survey respondents indicated a desire for more sophisticated asset location and structuring which points to the structures utilized by the UHNW. The desire for more sophisticated asset allocation that integrates alternative investments is evidenced by the rapid growth of iCapital as a distribution channel of alternative investments through RIAs. Clearly there is a demand among the HNW to invest alongside sovereign wealth funds, endowments, and pension funds with upper quartile alternative asset managers. As this demand grows and matures, I am certain that the desire for more sophisticated structuring around alternative investments will also grow. When a business family sees the long-term mathematical impact of asset location with the same underlying investments, the value of the proper structuring becomes clear.

When one considers that many business families already have a permanent life insurance policy that may be outdated, underperforming, or underfunded, it enhances the notion of further demand. Due to the efficiencies of the 1035 tax-free exchange, those older policies can likely be exchanged into a PPLI contract with no tax implications. Insurance carriers would do well to take consideration of the market opportunity combining the growth in alternative investments and fintech that allows for economies of scale, the size of the HNW demographic compared to the size of the UHNW, the changing tax environment, opportunities for clients to 1035 exchange old policies, life insurance statistics among buying demographics, and the growing demand for advanced planning and sophisticated structuring evidenced by the survey. These trends make it clear that an opportunity exists for insurance carriers that are committed to the PPLI space to increase their revenue through working with RIAs and professional insurance advisors to increase the number of policies issued and premiums deposited.

Implications for Academic Institutions - Family Business Institutes

The goal of this research was to identify the gaps in knowledge among business families and inquire about which topics would be most beneficial for an academic business family institute. The word institute is commonly used to describe organizations that are carrying out research at the highest level or to professional bodies of the highest standing. Fortunately, we are living in a time where technology has opened the door to create a digital institute for business families with relevant educational resources housed in a digital video library.

This survey was highly important because it clarified educational opportunities that are relevant and meaningful for business families. Helping main street businesses with purposeful planning through educational content will increase the cycle of wealth creation and planned giving. By uncovering the gaps in knowledge, I suggest the most interesting topics to the business family community and reduce the asymmetry of information between UHNW and HNW families. Because there are approximately 100 times more HNW families than UHNW, this research represents a tremendous market opportunity. The HNW demographic represents the most profitable segment in banking and other financial services.

Limitations & Assumptions

The primary limitation of this research is the uncertainty of future tax rates and their impact on the arrangement. When it comes to tax rates, the only thing we can be certain of is change. The calculations and conclusions of this research have a time stamp of 2021 and must be applied for future years carefully. If exemption amounts and tax rates adjust, the non-MEC model may no longer be the optimal arrangement for a HNW business family.

Further limitations of the survey research are sample size and sample bias. The survey sample size of 59 respondents was still a relatively small sample size for the survey and most were located primarily in Washington and California. The sample was drawn from a population of accredited investors and business families to uncover knowledge levels in the areas of PPLI, DAFs, family foundations, qualified retirement plans, commercial real estate, dynasty trusts, private equity, ILITs, and family bank structures. HNW business families are remarkably busy and generally value privacy. I was delighted to surpass the research goal of 50, but also recognize there are firms that have a broader reach into the demographic such as US Trust (i.e., Bank of America), who regularly conducts annual surveys among HNW nationwide. A lack of time and resources limited me from conducting a nationwide survey.

Limitations on the professional interviews were related to time constraints and COVID-19. The sample was drawn from a population of professionals that have experience working with PPLI in various contexts including, but not limited to, estate & tax attorneys, private banking & trust officers, alternative asset managers, lobbyists & policy advocates, insurance companies, IDF and SMA administrators, and experienced insurance advisors. All interviews were conducted virtually, which may have limited further information from being shared as an in-person interview may have made the interviewee more comfortable to share longer.

Finally, the limitations on the time series analysis are primarily related to the tax calculations on the comparative investment. Whether we are analyzing the efficiency of the PPLI policy against private credit, hedge fund, or a passive S&P 500 index, each will have different tax characteristics. The behavioral finance component was not factored here, as most families do not hold the S&P 500 index as their sole investment without ever selling or diversifying their assets further (taxed as long-term capital gains, while dividends are taxed at different rates).

Private credit (interest taxed as ordinary income) and hedge funds (predominantly short-term gains taxed as ordinary income) all compare differently from a tax alpha perspective. Tax alpha can be described as the practice of leveraging tax-saving strategies to maximize your after-tax returns. Hence, the appropriate analysis considers various tax levels of ordinary income, short term capital gains, long-term capital gains, ACA tax, and a state income tax. Further, the S&P 500 pays dividends each year that are qualified and must be taxed in the model. I assumed a 2% dividend rate for the S&P 500. To make the S&P 500 comparison more accurate, I calculated the fractional cost basis of the holdings during the withdrawal period of age 65 to 84 to ensure the basis was not taxed. The management fee for the S&P 500 was set to .0015% to reflect the expense ratio and custodial fees. For comparison, the hedge fund was assigned a 2% management fee and private credit was assigned a 1% management fee. The return profile of the S&P 500 was illustrated at 12%/9% throughout all years, while the hedge fund was 12%, and private credit was at 8%.

The overall objective of long-term growth was the primary focus, which is why private equity was chosen as the investment of choice within the PPLI construct and illustrated at a 12% return until age 65 then adjusted to an alternative income approach with a 9% return until age 84. The PPLI numbers are derived from an actual illustration with a top insurance carrier and are net of all fees and expenses.

The financial planning assumptions included a 3% inflation rate on the monthly income needs, and any overage of the monthly income needs was reinvested into a global commercial real estate fund focused on multi-family and industrial buildings with a 6% assumed return. Further, in the financial plans for Kristina, Annika, and Erikson, I did not calculate RMDs or taxes. I believe this is not central to the research questions of isolating the PPLI tax alpha against the same inputs and outputs, as the outside assets are calculated separately.

The assumptions in the time series analysis, the financial plans, and corresponding case study can all be found listed in the appendices. The spreadsheet model supports the analysis by providing clarity into all the assumptions and a numerical description of the various changes of assumptions at retirement age.

The research is less valuable to someone who is not interested in philanthropy. I am biased towards the societal transformation that is possible when business families lean into generosity particularly among the poorest in their communities.

The Reverse Endowment Model utilizes qualified retirement plans to grow assets on a pre and post-tax basis. Aside from being complex and nuanced, some of the challenges of qualified retirement plans are the RMD, as the IRS will not allow you to keep retirement funds in the account indefinitely. This is one of the only types of accounts that requires you to start withdrawing funds even if you do not want to. An RMD is the annual amount that you must start taking out of your retirement account after you reach age 72. The amount is determined by the fair market value of your IRAs at the end of the previous year, factored by your age and life expectancy. The entire pre-tax balance will be taxed at ordinary income tax rates and, under a progressive tax structure, make it one of the least beneficial assets to leave to heirs. I am biased to receiving lifetime income from the IRA, and leaving the remainder to a spouse, with a charity as the contingent beneficiary. Naturally, qualified retirement accounts are also exposed to tax law changes, as the tax rate assessed will be the prevailing tax rate at the time of distribution.

Real estate can be viewed as an expensive investment that is illiquid. It is often laden with heavy commissions and requires a long-term investment horizon. Market conditions can have a significant impact on the price of real estate and it is highly localized. Commercial real estate can generally be segmented into four categories: multi-family, industrial, office space, and retail. The first two categories have performed the best in recent years, with multi-family being one of the most stable performers over the long haul. Furthermore, it is my perspective that quality real estate is an ideal hedge against inflation, while still receiving cash flow (unlike gold or commodities).

The benefits of cash value life insurance can include tax deferred growth, lifetime insurability, access to cash value on a tax-free basis, and sometimes accelerated benefits that pay a portion of the death benefit before someone dies if they have chronic or critical illness. However, cost is one of the most important elements of analyzing cash value life insurance. All costs can have a drag on returns, and I encourage readers to analyze the cost of insurance and the M&E charges associated with any permanent policy. For PPLI, it is an institutionally priced arrangement, but may involve additional legal and accounting fees for establishing an LLC or trust in a favorable jurisdiction such as South Dakota, Alaska, or Delaware.

The tax alpha could have been further amplified if the research team used an ILIT to cover any remaining estate tax liabilities on revocable trust assets. If it was structured as a split-dollar ILIT, the amplification may have been more pronounced. Further studies could analyze the addition to the model.

Although private equity represents one of the best performing asset classes, it can be difficult to identify or access a skilled and experienced private equity investment team. Further, it can be difficult to properly diversify into private equity as the minimums on traditional private equity funds for qualified purchasers are typically $250,000. The risk of private equity is usually greater than real estate because it is a business rather than a tangible asset that is being purchased. However, it also has significant upside potential for growth with a favorable exit of the underlying business to a strategic buyer or an IPO on the stock exchange. Upper quartile managers, private equity managers that perform among the top 25% of all private equity managers, generally have a more consistent return profile. In the end, private equity managers are paid to actively manage the portfolio of companies through to the exit, which can require a significant amount of skill and experience. Because of this, the investment costs are usually much more than a passively managed index. However, it is my bias that the total net return to the investor is of greater importance than the amount of fees incurred to deliver the net return.

Recommendations for Future Research

Recommendations for future research might include a deeper dive into the new phenomena of the virtual family office. This new arrangement is a catalyst for bridging asymmetry of knowledge among practitioners and business families as it creates access points for families in rural communities to access world-class advisors in a geographically unconstrained manner. Future research could also incite discussion around single family, multi-family, and professional family offices and their utilization of PPLI. This comparison could analyze the metrics around the premium size and how the arrangement is used by single family offices, MFOs, and PFOs or private banks. Similarly, there could be discussion around single family offices and their utilization of dynasty trusts and family bank constructs. Historically speaking, the Rockefeller family established one of the first family offices in 1882 to consolidate their wealth management needs into one centralized organization. The primary benefit of a family office is a single point of contact to manage a collection of service providers and support the family unit in their journey through the challenges and responsibilities of significant wealth.

Typically, the family office discussion begins when a family sells a privately-owned business or begins to see the financial windfalls associated with professional sports or entertainment. The concept of the family office has become increasingly more common in recent years, although the terminology has been widely misused and mostly limited to the financial matters of the family. Because costs associated with operating a fully diversified family office average $1 million per year, the traditional single-family office usually forms when a family has liquid assets above $100 million.

It is not uncommon for the family business to represent 80-90% of a family's net worth. This is precisely why succession and estate planning play a vital role in the lives of entrepreneurs. When a privately-owned business is sold for a large amount of money and the entrepreneur is no longer in control of the company, it can present some unique challenges. What is needed at that point is a family CFO to make sure that the family gets the big picture right. Although incredibly competent, investment bankers and business brokers do not normally provide a service model to assist on the back end of a liquidity event. Furthermore, due to the relatively small amount of liquid investments prior to the sale, the incumbent investment brokers are typically ill-prepared to handle the windfall. Often, the entrepreneur has a high degree of trust built with their in-house accounting team and will recruit them to serve in the capacity of a family CFO over their newfound liquid wealth. A new entity is typically born and the single-family office is formalized.

The creation of a single-family office can be problematic because the technical knowledge base necessary for a corporate CFO is vastly different from the knowledge base necessary for a family CFO. Furthermore, it is unlikely that the corporate controller possesses a rolodex of deep relationships with top-talent specialist providers. Much in the same way that a seasoned and well-respected general contractor is used to build a home for an affluent family, a skilled and experienced family CFO can ensure that the project moves forward with precision using their high level of technical knowledge and extensive relationships with specialists. Unfortunately, those qualities are rarely possessed by the corporate controller. On a side note, in my professional opinion, I believe that the corporate controller can play a trusted and significant role in the cash flow monitoring and execution of the family CFO's direction.

As a single-family office grows and tries to improve their operations, sometimes they merge with other families to create a multi-family office. There has been a significant shift from single family offices (SFOs) to multi-family offices (MFOs) in recent years, as families understand the benefits associated with pooling resources and staff. Furthermore, it elevates the quality of specialist service providers (e.g., attorneys, CPAs, asset managers, insurance planners) due to the families sharing notes and their experiences. As the momentum builds, it does not take long to clearly identify the superiority of an open-architecture service model seeking to engage only top-talent professional and specialist service providers in a coordinated manner. Very few top-talent asset managers or other professional advisors will ever agree to work exclusively within the walls of a single-family office as a wage earner, and one of the best ways to access that talent is through a multi-family office.

An early-stage MFO can face significant compliance and operational complexities due to the Dodd-Frank Wall Street Reform and Consumer Protection Act. Since 2011, most MFOs are no longer excluded from regulation under the Investment Advisors Act of 1940, which allowed them previously to provide investment advice to a certain amount of non-family members. The point is that establishing and operating a professional operation of this magnitude generally needs an operating budget above $2 million per year to be excellent.

The most mature family offices of today and the next generation family offices of tomorrow are holistic in their perspectives. The needs go far beyond traditional private banking service models with a one-dimensional focus on the financial affairs of the family to a wide range of services tailored to fit the individual needs of each person and to see them flourish in their family, health, and wealth. This new approach to holistic wellness provides leadership and coaching in best-practices from a team of top-talent professionals that allow a family to live well and build a legacy through intentionality in matters concerning their family communication and security, as well as their health and wealth. Family CFOs are utilized to architect and oversee the financial management, as a single point of contact. Family Communication Advisors are utilized to facilitate greater levels of trust and communication by using an array of practical tools and family retreats. Philanthropic advisors to the family can help facilitate discussions around developing a family impact plan. Family Security Advisors architect and oversee the security policies and practices of the family. Finally, the Family Wellness Advisors create a multi-faceted and customized health and wellness plan for every family member. Once again, the main benefit of the family office is centralized planning and management congruent with the family's goals and values.

Future research could analyze the discrepancies in state premium tax levels and insurance regulations on in-kind distributions. Understanding why these discrepancies are so wide and its effect on insurance distribution would be of benefit for insurance carriers and executives to understand. It would also be interesting to research the best practices about how PPVAs are utilized in charitable planning for UHNW families.

Additional research can be conducted to further understand social impact per dollar invested. Storm (2006) wrote that donors are interested in dictating how their tax dollars should be allocated and further seem to be interested in directing wealth to charity and family instead of the government. It is outside the scope of this research project to measure the social impact of dollars granted to charities vs. tax revenues being utilized for social impact and wealth redistribution. Clearly the IRS tax code encourages charitable donations to create an additional safety net for vulnerable and disadvantaged demographics. Further research is needed whether the estate tax redistributes wealth to the poor versus the efficiency of non-governmental organizations and charities. Practically speaking, Oxfam and WorldVision are exceptional at utilizing funds for social impact. Public/private partnerships can also be researched, as the government seeks to outsource or subsidize operational efforts towards serving and educating those most vulnerable. If tax revenue is redirected per the Internal Revenue Code rules to support charities, is that a more efficient tool to create meaningful social support programs at the grassroots level or is the federal government? Clearly there is social impact through both channels, but future research might consider measuring the net dollars going to programs (i.e., usually over 90% in high performing NGOs) between both routes. Haiti would be an interesting case study to measure the difference between the two channels of either government social programs or entitlements vs. non-governmental organizations. More investigation here may help maximize the utilization of charitable funds towards optimal social impact.

It would also be interesting to research the shift of long-term care (LTC) insurance benefits from a traditional LTC policy to living benefit riders on a life insurance contract. It is now common for insurance carriers to include living benefits (for chronic, critical, or terminal illness) on permanent life insurance policies to cover long-term care needs. Will these benefits be negotiated into a PPLI policy in the future?

Additional research could be conducted regarding the efficacy of the family foundation as a tool to train children for the responsibilities of wealth. Most children have not been trained or prepared for wealth. Furthermore, it is not something that they are going to learn in school, even at an Ivy League university. Family meetings and discussions are where children are best educated about family wealth principles. In my opinion, the best type of family meeting for these discussions are family foundation meetings facilitated by a team of non-family professional advisors. At these meetings, advisors can facilitate meaningful discussions about resources that may be available to the children and about the responsibilities that come with significant wealth.

A family foundation meeting can be a refreshing change to the routine of everyday life. According to Collier (2012), the family foundation is a powerful teaching tool that provides a safe environment in which children can learn about money management and it can also strengthen the family. Collier believes that the family foundation offers an ideal place to begin and continue financial education for children because a well-run foundation reviews and manages grant requests, requires accountability for previous grants, and works with professional advisors in the management of the foundation's resources and investment policy.

The family foundation meeting is also a great place to develop a family mission statement to reinforce a family's core values. According to Collier (2012), involving loved ones in charitable activities can help strengthen family relationships, create a shared sense of purpose, and promote a lasting legacy for the family.

Conclusion

The conclusion of this research supports the notion that it is possible for a business family to structure a PPLI policy to create the same simulated after-tax financial outputs (such as retirement income and inheritance to their children) as a standard account arrangement, with additional assets going to 501(c)3 charities for enhanced planned giving. The various structures were analyzed for the UHNW, HNW, and foreign UHNW populations to understand the most typical structure for each demographic. This was beneficial for greater knowledge among practitioners and the families they represent. The surveys indicated a legitimate interest and market demand for PPLI and dynasty trust planning among the HNW. This demand for more advanced planning is both real and unmet. This dislocation of unmet demand is centered on the supply side, as many advisors (attorneys, CPAs, investment advisors, and insurance professionals) are also unaware and unable to educate their clients about the beneficial elements of dynasty trusts and PPLI. The supply side is further disincentivized to teach themselves or educate others as retail insurance products (such as whole life) compensate traditional insurance brokers with higher commissions than PPLI.

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APPENDIX A: IRB APPROVAL LETTER

Date: August 21, 2020

Protocol Investigator Name: Kristofer Gray

Protocol #: 19-12-1250

Project Title: The Reverse Endowment Model: Increasing a Business Family's planned giving through Private Placement Life Insurance and Dynasty Trusts.

School: Graziadio School of Business and Management

Dear Kristofer Gray: Thank you for submitting your application for exempt review to Pepperdine University's Institutional Review Board (IRB). We appreciate the work you have done on your proposal. The IRB has reviewed your submitted IRB application and all ancillary materials. Upon review, the IRB has determined that the above entitled project meets the requirements for exemption under the federal regulations 45 CFR 46.101 that govern the protections of human subjects. Your research must be conducted according to the proposal that was submitted to the IRB. If changes to the approved protocol occur, a revised protocol must be reviewed and approved by the IRB before implementation. For any proposed changes in your research protocol, please submit an amendment to the IRB. Since your study falls under exemption, there is no requirement for continuing IRB review of your project. Please be aware that changes to your protocol may prevent the research from qualifying for exemption from 45 CFR 46.101 and require submission of a new IRB application or other materials to the IRB. A goal of the IRB is to prevent negative occurrences during any research study. However, despite the best intent, unforeseen circumstances or events may arise during the research. If an unexpected situation or adverse event happens during your investigation, please notify the IRB as soon as possible. We will ask for a complete written explanation of the event and your written response. Other actions also may be required depending on the nature of the event. Details regarding the timeframe in which adverse events must be reported to the IRB and documenting the adverse event can be found in the Pepperdine University Protection of Human Participants in Research: Policies and Procedures Manual at community.pepperdine.edu/irb. Please refer to the protocol number denoted above in all communication or correspondence related to your application and this approval. Should you have additional questions or require clarification of the contents of this letter, please contact the IRB Office. On behalf of the IRB, I wish you success in this scholarly pursuit.

Sincerely, Judy Ho, Ph.D., IRB Chair

cc: Mrs. Katy Carr, Assistant Provost for Research

APPENDIX B: RESEARCH INSTRUMENTS

Interview Questions for Professional Advisors

1. In your opinion, what are the main benefits of a PPLI arrangement for a family?
2. What has been your most memorable experience or case study as it relates to private placement life insurance?
3. What does a typical PPLI case study look like?
4. What are the optimal asset classes or investment allocations inside PPLI arrangements for the following:
    a. UHNW with a commitment to fund $22mm
    b. Foreign UHNW with a commitment to fund $22mm
    c. HNW with no lump sum investment, but able to fund $22k per month
    d. Can you think of any noteworthy insurance dedicated funds or separately managed accounts that fit well inside a PPLI arrangement?
5. In order to optimize tax alpha, how do you normally see trust and entity structuring for each group paying special attention to owners and beneficiaries (ILIT, Dynasty Trust, Family LLC, Beneficiaries, Trustees, Jurisdictions),
    a. UHNW with a commitment to fund $22mm,
        i. Owner
        ii. Beneficiary
    b. Foreign UHNW with a commitment to fund $22mm,
        i. Owner
        ii. Beneficiary
    c. HNW with no lump sum investment, but able to fund $22k per month
        i. Owner
        ii. Beneficiary
6. What is the optimal insurance policy product structuring for a 44 year old female non-smoker in excellent health.
    a. UHNW with a commitment to fund $22mm
        i. MEC/non-MEC
        ii. 5-pay/guideline level
        iii. Increasing/level death benefit
        iv. Type of loans
        v. Policy guarantees
        vi. Living benefits - Chronic Illness
    b. Foreign UHNW with a commitment to fund $22mm
        i. MEC/non-MEC
        ii. 5-pay/guideline level
        iii. Increasing/level death benefit
        iv. Type of loans
        v. Policy guarantees
        vi. Living benefits - Chronic Illness
    c. HNW with no lump sum investment, but able to fund $22k per month
        i. MEC/non-MEC
        ii. 5-pay/guideline level

iii. Increasing/level death benefit
iv. Type of loans
v. Policy guarantees
vi. Living benefits - Chronic Illness

7. Why have HNW, and foreign-UHNW families been slow to adopt PPLI thus far? Is it a phenomena of information asymmetry between the UHNW and the other groups? Is there a market failure caused by one party having more or better information than the others? Has it created adverse selection or monopolies of knowledge?
8. Do you know of any meaningful statistical data sources on PPLI?
9. How have you seen philanthropy incorporated into the PPLI structure (family foundations, donor advised funds, etc.) or similar structures (PPVA)?
10. Is there something else you think I should know to understand PPLI better?

Informed Consent Document for Interviews:

PEPPERDINE INSTITUTIONAL REVIEW BOARD INFORMED CONSENT DOCUMENT RESEARCHER'S NAME: KRISTOFER R. GRAY RESEARCHER'S CONTACT INFORMATION: KRISTOFER.GRAY@PEPPERDINE.EDU PROJECT TITLE: THE REVERSE ENDOWMENT MODEL: INCREASING A BUSINESS FAMILY'S PLANNED GIVING THROUGH PRIVATE PLACEMENT LIFE INSURANCE AND DYNASTY TRUSTS. YOU ARE BEING ASKED TO VOLUNTEER TO PARTICIPATE IN A RESEARCH STUDY YOU ARE BEING ASKED TO PARTICIPATE IN A RESEARCH STUDY. THIS RESEARCH IS BEING CONDUCTED TO HELP INVESTIGATE THE LEGITIMACY OF PRIVATE PLACEMENT LIFE INSURANCE AND DYNASTY TRUSTS AS A TOOL FOR FAMILIES BELOW $30MM OF NET-WORTH. WHEN YOU ARE INVITED TO PARTICIPATE IN RESEARCH, YOU HAVE THE RIGHT TO BE INFORMED ABOUT THE STUDY PROCEDURES SO THAT YOU CAN DECIDE WHETHER YOU WANT TO CONSENT TO PARTICIPATION. THIS FORM MAY CONTAIN WORDS THAT YOU DO NOT KNOW. PLEASE ASK THE RESEARCHER TO EXPLAIN ANY WORDS OR INFORMATION THAT YOU DO NOT UNDERSTAND. YOU HAVE THE RIGHT TO KNOW WHAT YOU WILL BE ASKED TO DO SO THAT YOU CAN DECIDE WHETHER OR NOT TO BE IN THE STUDY. YOUR PARTICIPATION IS VOLUNTARY. YOU DO NOT HAVE TO BE IN THE STUDY IF YOU DO NOT WANT TO. YOU MAY REFUSE TO BE IN THE STUDY AND NOTHING

WILL HAPPEN. IF YOU DO NOT WANT TO CONTINUE TO BE IN THE STUDY, YOU MAY STOP AT ANY TIME WITHOUT PENALTY OR LOSS OF BENEFITS TO WHICH YOU ARE OTHERWISE ENTITLED. PURPOSE: THE PURPOSE OF THIS RESEARCH IS TO INVESTIGATE THE LEGITIMACY OF PRIVATE PLACEMENT LIFE INSURANCE (PPLI) AS A TOOL FOR FAMILIES BELOW $30MM OF NET-WORTH. ALSO, TO ADD TO THE ACADEMIC LITERATURE REGARDING PPLI BY RESEARCHING THE BEST-PRACTICES IN POLICY DESIGN AND TRUST ARRANGEMENTS TO MAXIMIZE THE PLANNED GIVING OF THE HIGH NET-WORTH FAMILY. THIS STUDY WILL TAKE APPROXIMATELY 1 YEAR TO COMPLETE, AND YOU MAY BE CALLED UPON FOR FURTHER CLARIFICATION OF YOUR ANSWERS DURING THAT TIME FRAME. EACH INTERVIEW SESSION WILL TAKE APPROXIMATELY 1 HOUR. YOU WILL BE ASKED TO ANSWER INTERVIEW QUESTIONS ABOUT THE IDEAL POLICY AND TRUST/ENTITY STRUCTURING FOR EACH OF THREE CASE STUDY GROUPS: 1) HIGH NET-WORTH (U.S. FAMILY), 2) ULTRA-HIGH NET-WORTH (U.S. FAMILY), AND 3) FOREIGN ULTRA-HIGH NET-WORTH. THERE WILL BE AROUND 15 PEOPLE IN THE STUDY. YOUR PARTICIPATION IN THIS STUDY IS NOT EXPECTED TO CAUSE YOU ANY RISKS GREATER THAN THOSE ENCOUNTERED IN EVERYDAY LIFE. INTERVIEWS WILL BE VIDEO AND AUDIO-RECORDED USING ZOOM AND TRANSCRIBED FOR LATER ANALYSIS. ALL INFORMATION AND RECORDINGS WILL BE CONFIDENTIAL AND THE SUBJECTS WILL ALSO HAVE THE OPPORTUNITY TO STAY IN THE STUDY AND NOT BE RECORDED IF THEY PREFER. I WILL KEEP THE DATA CONFIDENTIAL IN THE FOLLOWING WAYS:1. INTERVIEWS WILL BE STORED ON AN ENCRYPTED DEVICE OR IN A SECURE CLOUD 2. INTERVIEWS WILL NOT BE SHARED FOR NON-ACADEMIC, NON-EDUCATIONAL, OR NON-BUSINESS RELATED PURPOSES, AND INFORMED CONSENT WILL BE OBTAINED PRIOR TO CONDUCTING INTERVIEWS. ALTHOUGH THE INFORMATION IS IDENTIFIABLE, ANY DISCLOSURE OF THE SUBJECT'S RESPONSES OUTSIDE OF THE RESEARCH COULD NOT REASONABLY PLACE THE SUBJECT AT RISK OF CRIMINAL OR CIVIL LIABILITY OR BE DAMAGING TO THE SUBJECT'S FINANCIAL STANDING,

EMPLOYABILITY, EDUCATIONAL ADVANCEMENT, OR REPUTATION. THE INTERVIEW QUESTIONS ARE PROFESSIONAL IN NATURE AND PERTAIN TO THE DAILY BUSINESS ACTIVITIES OF THE SUBJECT POPULATION AND DOES NOT INCLUDE ANY INDIVIDUAL PERSON'S SENSITIVE DATA OR INFORMATION. YOU ALSO HAVE THE OPTION OF NOT PARTICIPATING IN THIS STUDY, AND YOUR DECISION WILL BE RESPECTED. THE INFORMATION YOU WILL PROVIDE IS NOT CONSIDERED SENSITIVE PERSONAL DATA, AND MAY BE UTILIZED FOR EDUCATIONAL AND BUSINESS PURPOSES IN THE FUTURE. IF YOU DESIRE CONFIDENTIALITY OF YOUR IDENTITY AND PARTICIPATION, PLEASE NOTIFY THE RESEARCHER PRIOR TO PROCEEDING WITH THE INTERVIEW. YOU WILL RECEIVE NO COMPENSATION FOR PARTICIPATION IN THE STUDY. INVESTIGATOR CONTACT INFORMATION: KRISTOFER GRAY, 24955 PACIFIC COAST HWY, SUITE B202, MALIBU, CA 90265. 310-579-7625, KRISTOFER.GRAY@PEPPERDINE.EDU. YOU MAY CONTACT THE CAMPUS INSTITUTIONAL REVIEW BOARD IF YOU HAVE QUESTIONS ABOUT YOUR RIGHTS, CONCERNS, COMPLAINTS OR COMMENTS AS A RESEARCH PARTICIPANT. PEPPERDINE UNIVERSITY, IRB MANAGER, 310-568-2305.

Survey Questions for Accredited Investors and Business Families

1. Do you own a business?
2. Do you own a home?
3. Do you own an investment property or second home?
4. Do you have any grandchildren?
5. Please select one of the following
    a. I am a qualified purchaser as defined by at least $5+ million of investable assets
    b. I am an accredited investor as defined by at least $1 million of net worth, not including my primary residence
    c. I am an accredited investor as defined by income over $200,000 if single, or $300,000 if married
    d. My current annual income is below $200,000 or I am married and our joint income is below $300,000 combined.
6. How would you rate your personal knowledge and experience regarding the utility of DONOR ADVISED FUNDS and FAMILY FOUNDATIONS for business families and single family offices?

a. Extremely knowledgeable
b. Very knowledgeable
c. Moderately knowledgeable
d. Slightly knowledgeable
e. Not knowledgeable at all

7. How would you rate your personal knowledge and experience regarding the utility of QUALIFIED RETIREMENT PLANS for business families and single family offices?
    a. Extremely knowledgeable
    b. Very knowledgeable
    c. Moderately knowledgeable
    d. Slightly knowledgeable
    e. Not knowledgeable at all
8. How would you rate your personal knowledge and experience regarding the tax and investment benefits of REAL ESTATE for business families and single family offices? (1031 exchange, step-up, cost segregation depreciation, cash-out refinance, real estate professional status, qualified opportunity zone, etc.)
    a. Extremely knowledgeable
    b. Very knowledgeable
    c. Moderately knowledgeable
    d. Slightly knowledgeable
    e. Not knowledgeable at all
9. How would you rate your personal knowledge and experience regarding the utility of PRIVATE PLACEMENT LIFE INSURANCE and/or the income tax and investment benefits of CASH VALUE LIFE INSURANCE for business families and single family offices? (1035 tax free exchange, income tax free death benefit, tax free access to policy through withdrawal of basis and loans, asset protection from creditors, etc.)
    a. Extremely knowledgeable
    b. Very knowledgeable
    c. Moderately knowledgeable
    d. Slightly knowledgeable
    e. Not knowledgeable at all
10. How would you rate your personal knowledge and experience regarding the utility of DYNASTY TRUST and FAMILY BANK structures to minimize estate taxes for business families and single family offices?
    a. Extremely knowledgeable
    b. Very knowledgeable
    c. Moderately knowledgeable
    d. Slightly knowledgeable
    e. Not knowledgeable at all
11. How would you rate your personal knowledge and experience regarding the utility of an

IRREVOCABLE LIFE INSURANCE TRUST for estate liquidity needs of business families and single family offices?

   a. Extremely knowledgeable
   b. Very knowledgeable
   c. Moderately knowledgeable
   d. Slightly knowledgeable
   e. Not knowledgeable at all

12. How would you rate your personal knowledge and experience regarding the utility of upper quartile PRIVATE EQUITY managers and ALTERNATIVE INVESTMENTS for business families and single family offices?
    a. Extremely knowledgeable
    b. Very knowledgeable
    c. Moderately knowledgeable
    d. Slightly knowledgeable
    e. Not knowledgeable at all
13. In your opinion, do you think that the current U.S. National Debt of $27 trillion will likely be reduced in the future by a) reducing government expenditures, or b) increasing taxes to cover the annual federal deficit and begin reducing debt obligations?
    a. Reducing Federal government expenditures
    b. Increasing taxes to cover the annual federal deficit and begin reducing debt obligations
14. How interesting would it be for you to have a tax advisor calculate and explain how to cover the potential FEDERAL ESTATE TAX and STATE ESTATE TAX obligations on illiquid family assets such as businesses or real estate, or identify means to minimize INCOME TAX liabilities through purposeful planning and ASSET LOCATION techniques?
    a. Extremely interesting
    b. Very interesting
    c. Moderately interesting
    d. Slightly interesting
    e. Not interesting at all
15. What is your full name?
16. What is your email address?
17. What is your mobile phone number?
18. Is it ok to text you or email you about future correspondence related to this study?

Survey Cover Letter

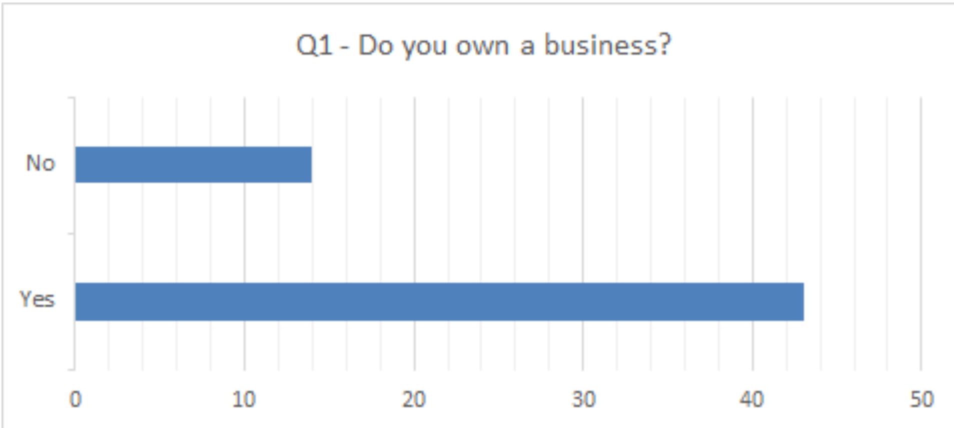
I AM WRITING TO REQUEST YOUR ASSISTANCE WITH AN IMPORTANT RESEARCH PROJECT, "WEALTH & TAX STRUCTURING SURVEY FOR BUSINESS OWNERS, EXECUTIVES, AND ACCREDITED INVESTORS," BEING CONDUCTED BY KRISTOFER GRAY, CFP® AT PEPPERDINE UNIVERSITY. AS PART OF A LARGER PROGRAM TO UNDERSTAND IF THERE IS A LATENT DEMAND FOR MORE SOPHISTICATED FINANCIAL STRUCTURING AMONG HIGH NET WORTH FAMILIES. I AM CONDUCTING A SURVEY OF BUSINESS FAMILIES AND ACCREDITED INVESTORS TO ASK ABOUT COMMON TAX STRUCTURING ARRANGEMENTS THAT ARE OFTEN USED BY THE ULTRA-HIGH NET-WORTH. THIS IS IMPORTANT BECAUSE THERE SEEMS TO BE AN ASYMMETRY OF KNOWLEDGE BETWEEN ULTRA-HIGH NET-WORTH BUSINESS OWNERS AND OTHERS. MOST BUSINESS OWNERS RELY ON THEIR PROFESSIONAL ADVISORS TO EDUCATE THEM ABOUT ADVANCED BUSINESS AND WEALTH STRUCTURING TOPICS. THE GOAL OF THIS SURVEY IS TO IDENTIFY THE GAPS IN KNOWLEDGE AND CREATE CURATED EDUCATIONAL CONTENT THAT CAN BE DISTRIBUTED AND ENJOYED DIGITALLY BY BUSINESS FAMILIES.

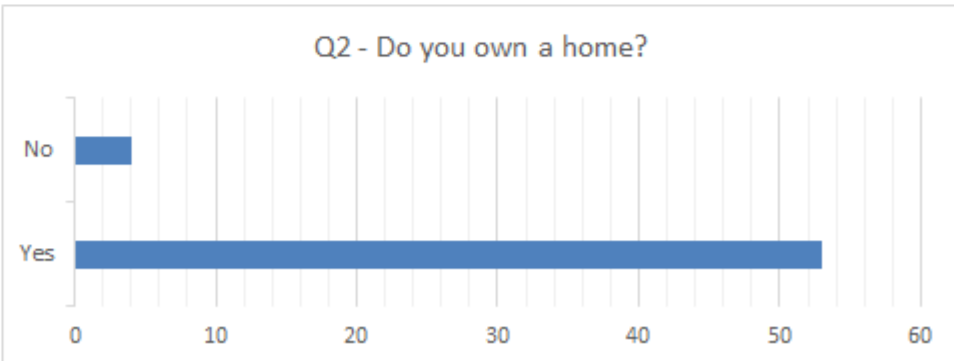
YOU WERE SELECTED TO BE PART OF THIS PROJECT BECAUSE YOU ARE RECOGNIZED AS A BUSINESS OWNER, ACCREDITED INVESTOR, OR LEADER IN THE MARKETPLACE. I CAN IMAGINE THE CHALLENGES ON YOUR TIME DUE TO COVID-19, BUT I REALLY HOPE YOU WILL TAKE SOME TIME TO PARTICIPATE IN THIS BRIEF SURVEY. THE QUESTIONNAIRE WILL REQUIRE ONLY 10 MINUTES TO COMPLETE AND CAN BE DONE FROM YOUR MOBILE DEVICE ON THE GO.

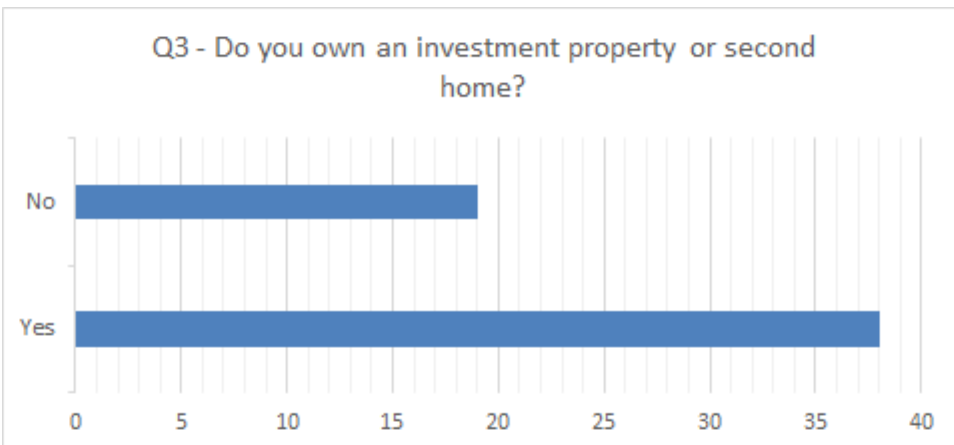
To complete the survey online, please access the URL below. Enter the respondent key that appears at the bottom of this letter, and then follow the online survey instructions.

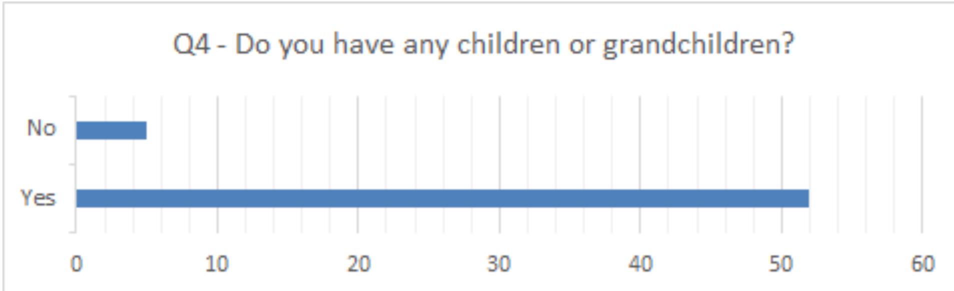
Participation is strictly voluntary, and you may refuse to participate or discontinue participation at any time. There is no risk involved, and your answers will be kept confidential by the researcher and his team. Your information will be utilized to determine which topics are most interesting, and once the research is completed, I will give respondents complimentary access to the online video vault of curated content. Completion and return of the questionnaire will indicate your willingness to participate in this study. Thank you in advance for your participation in this important research. If you have any questions about the administration of the survey, please contact our research offices at 425-802-2831 or Kristofer.gray@pepperdine.edu.

APPENDIX C: SURVEY RESULTS








Q4 - Do you have any children or grandchildren?
No
Yes
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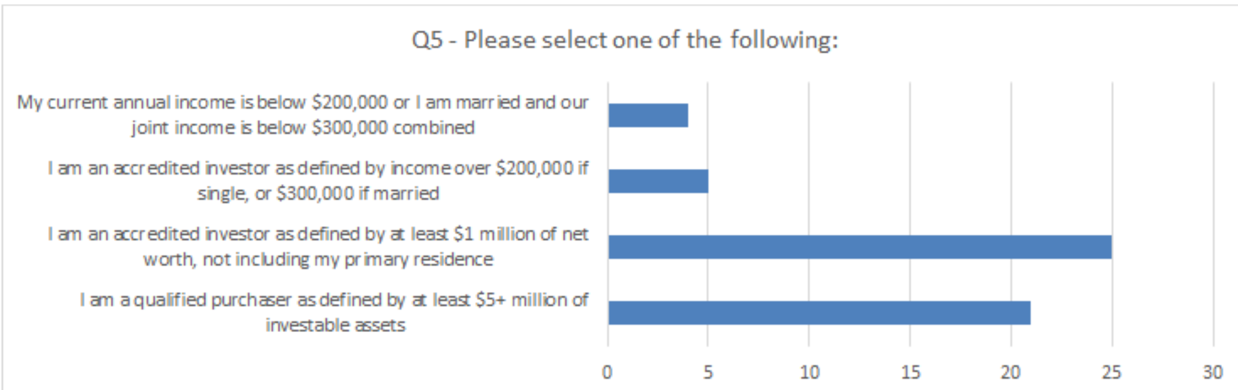
Q5 - Please select one of the following:
My current annual income is below $200,000 or I am married and our joint income is below $300,000 combined
I am an accredited investor as defined by income over $200,000 if single, or $300,000 if married
I am an accredited investor as defined by at least $1 million of net worth, not including my primary residence
I am a qualified purchaser as defined by at least $5+ million of investable assets
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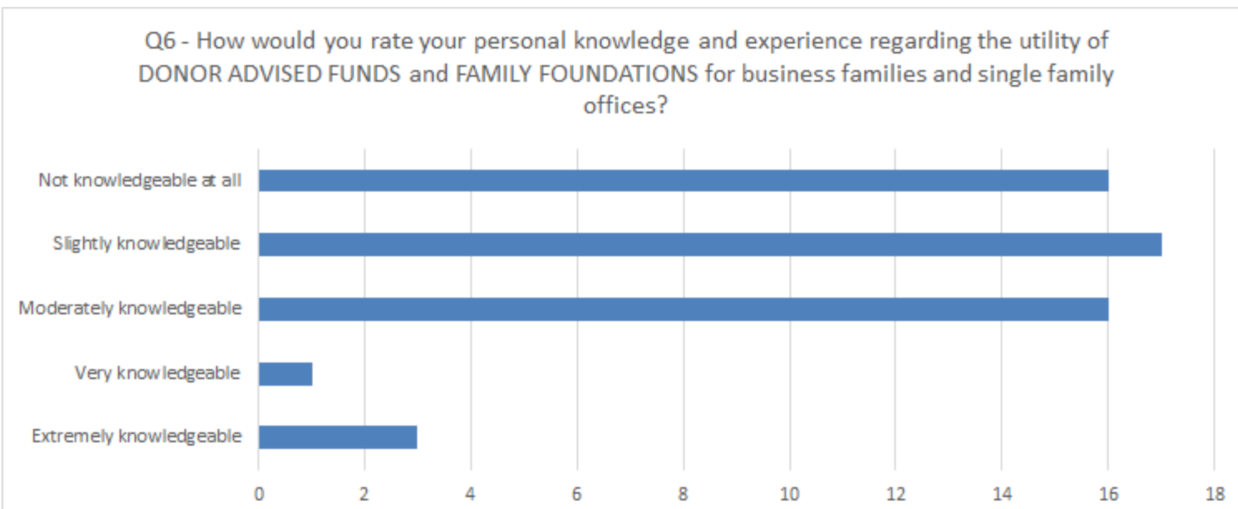
Q6 - How would you rate your personal knowledge and experience regarding the utility of DONOR ADVISED FUNDS and FAMILY FOUNDATIONS for business families and single family offices?
Not knowledgeable at all
Slightly knowledgeable
Moderately knowledgeable
Very knowledgeable
Extremely knowledgeable
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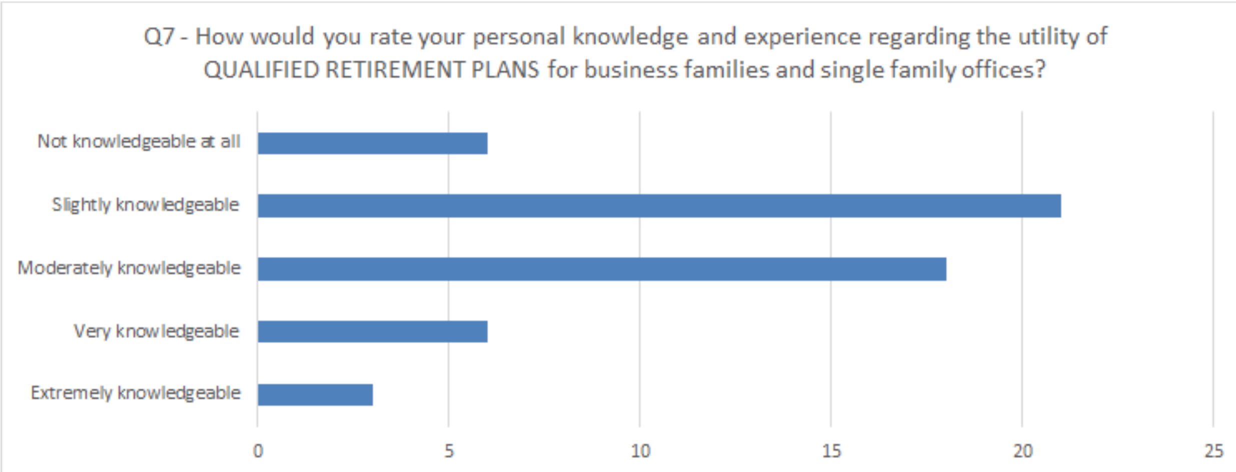
Q7 - How would you rate your personal knowledge and experience regarding the utility of QUALIFIED RETIREMENT PLANS for business families and single family offices?
Not knowledgeable at all
Slightly knowledgeable
Moderately knowledgeable
Very knowledgeable
Extremely knowledgeable
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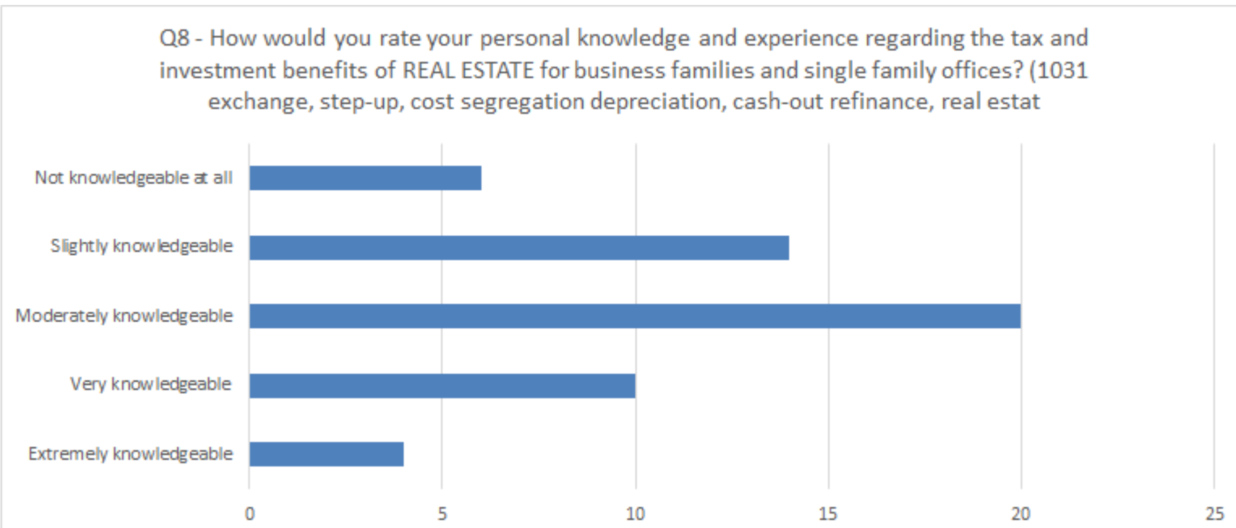
Q8 - How would you rate your personal knowledge and experience regarding the tax and investment benefits of REAL ESTATE for business families and single family offices? (1031 exchange, step-up, cost segregation depreciation, cash-out refinance, real estat
Not knowledgeable at all
Slightly knowledgeable
Moderately knowledgeable
Very knowledgeable
Extremely knowledgeable
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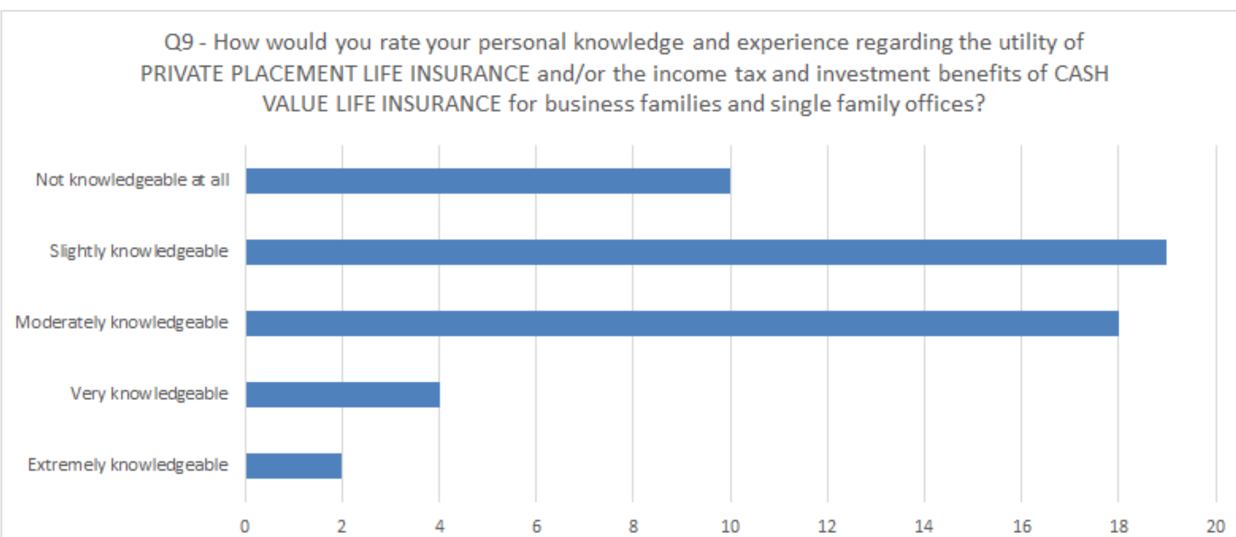
Q9 - How would you rate your personal knowledge and experience regarding the utility of PRIVATE PLACEMENT LIFE INSURANCE and/or the income tax and investment benefits of CASH VALUE LIFE INSURANCE for business families and single family offices?
Not knowledgeable at all
Slightly knowledgeable
Moderately knowledgeable
Very knowledgeable
Extremely knowledgeable
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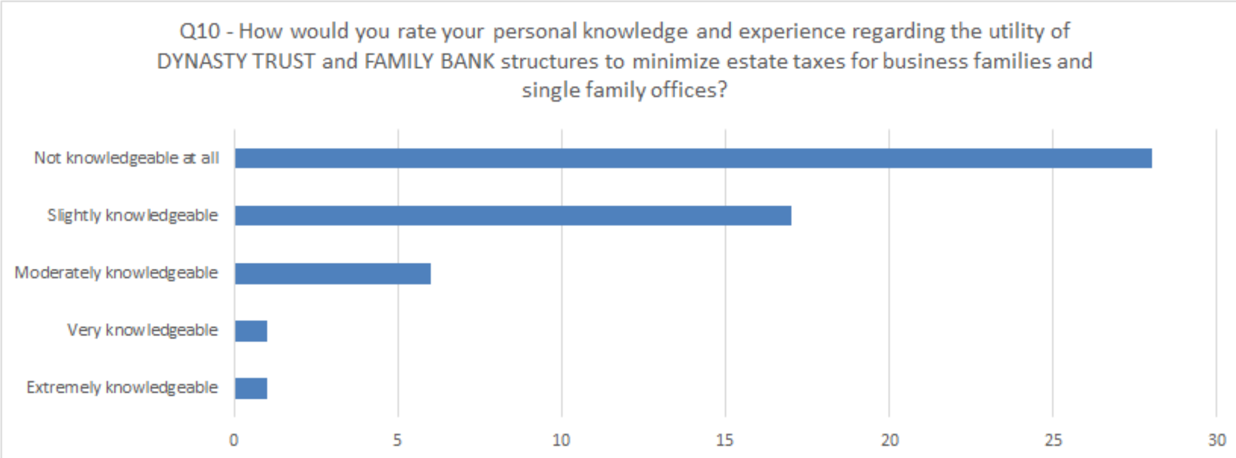
Q10 - How would you rate your personal knowledge and experience regarding the utility of DYNASTY TRUST and FAMILY BANK structures to minimize estate taxes for business families and single family offices?
Not knowledgeable at all
Slightly knowledgeable
Moderately knowledgeable
Very knowledgeable
Extremely knowledgeable
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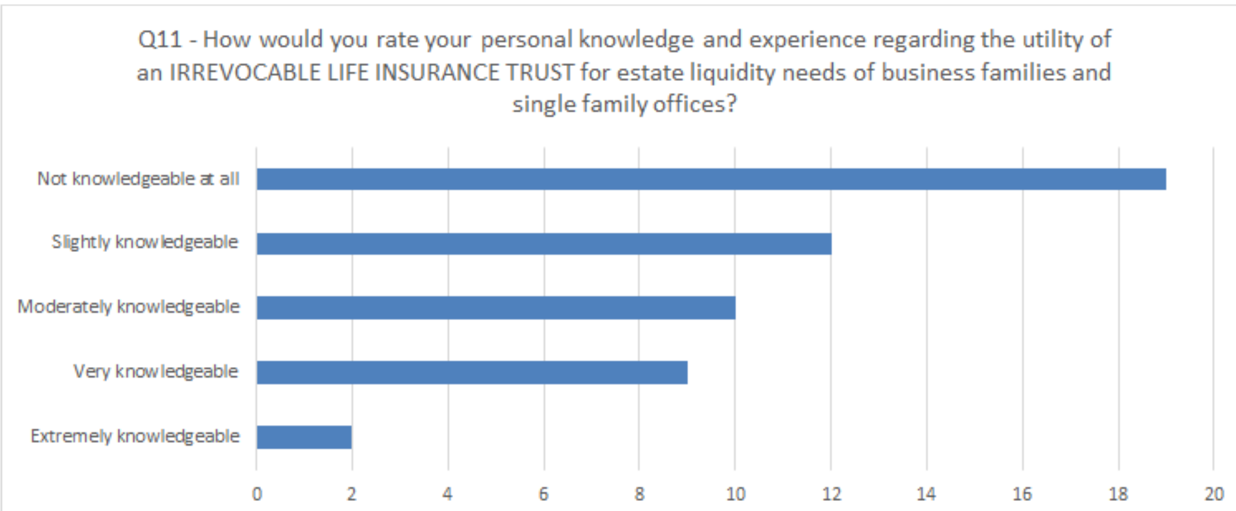
Q11 - How would you rate your personal knowledge and experience regarding the utility of an IRREVOCABLE LIFE INSURANCE TRUST for estate liquidity needs of business families and single family offices?
Not knowledgeable at all
Slightly knowledgeable
Moderately knowledgeable
Very knowledgeable
Extremely knowledgeable
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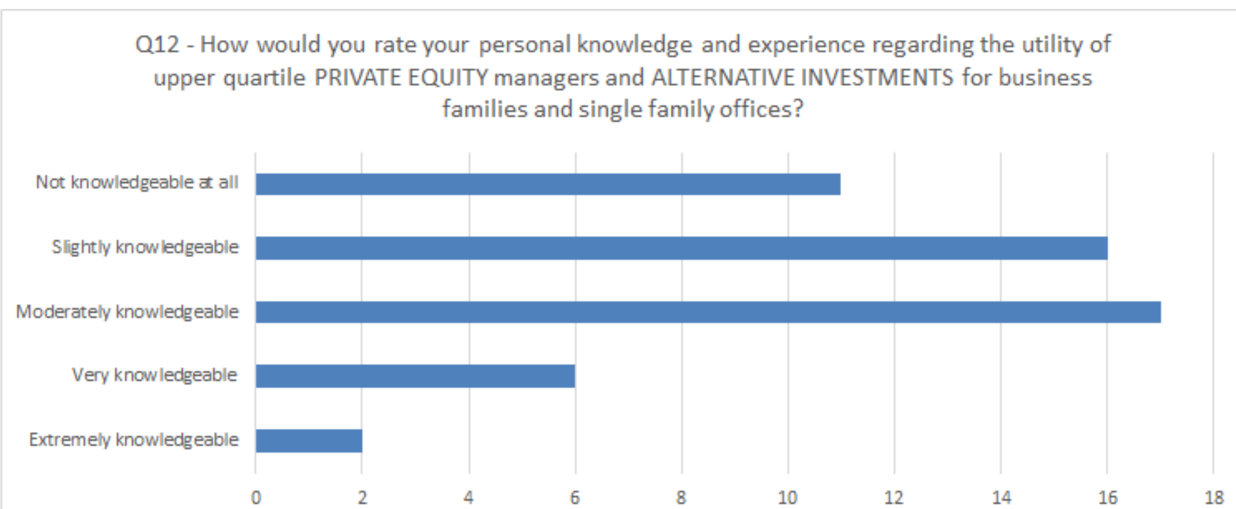
Q12 - How would you rate your personal knowledge and experience regarding the utility of upper quartile PRIVATE EQUITY managers and ALTERNATIVE INVESTMENTS for business families and single family offices?
Not knowledgeable at all
Slightly knowledgeable
Moderately knowledgeable
Very knowledgeable
Extremely knowledgeable
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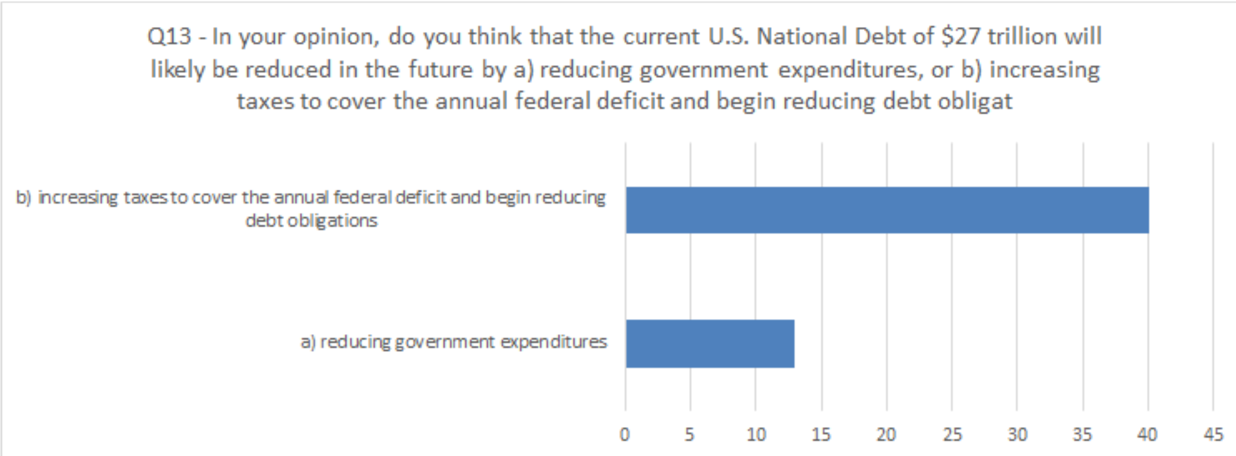
Q13 - In your opinion, do you think that the current U.S. National Debt of $27 trillion will likely be reduced in the future by a) reducing government expenditures, or b) increasing taxes to cover the annual federal deficit and begin reducing debt obligat
b) increasing taxes to cover the annual federal deficit and begin reducing debt obligations
a) reducing government expenditures
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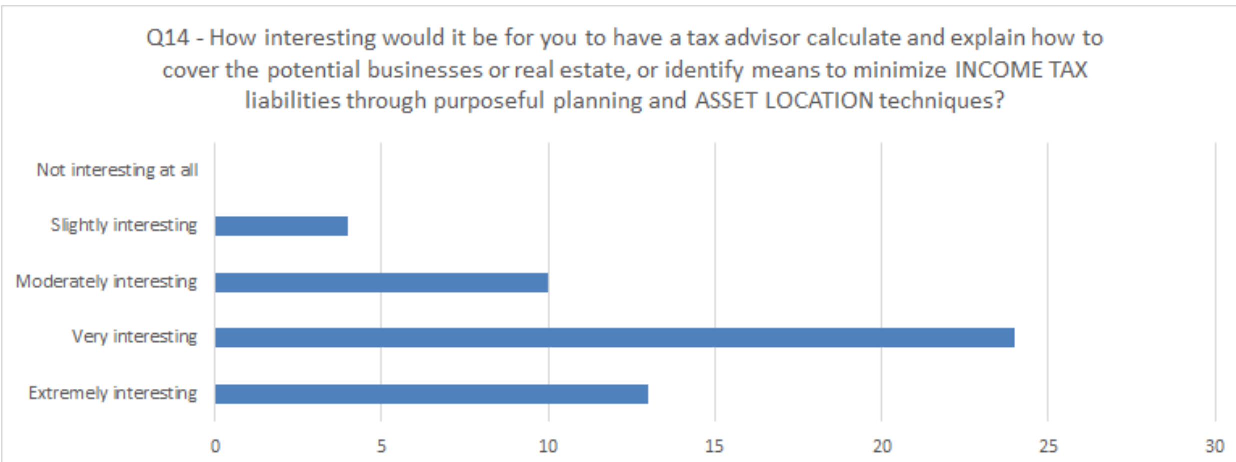
Q14 - How interesting would it be for you to have a tax advisor calculate and explain how to cover the potential businesses or real estate, or identify means to minimize INCOME TAX liabilities through purposeful planning and ASSET LOCATION techniques?
Not interesting at all
Slightly interesting
Moderately interesting
Very interesting
Extremely interesting
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APPENDIX D: CASE STUDY FINANCIAL PLAN AND ANALYSIS

Kristoferson Family Case Study - *A Main Street Business Sale*

Background: Kristina Kristoferson is a small business owner who lives with her husband and two children in Ballard, Washington. Ballard is a neighborhood in the northwest corner of Seattle and is the traditional center of Seattle's ethnically Scandinavian maritime community. Kristina's husband, Leif, is an electrician, and he is 46 years old. Kristina is 44 years old, and seeing her two children Annika (age 10) and Erikson (age 8) grow to become mature and contributing citizens in the community is one of her top priorities as a parent.

Seventeen years ago, Kristina utilized a Small Business Administration (SBA) loan through a local bank to purchase a small candy store in Ballard that she had worked in from the time she was 15. After owning the store for the first five years, she decided to expand the business into a chocolate importing business as well, while maintaining her traditional candy storefront. Her local Small Business Development Council (SBDC) consultant coached her through this expansion, and she was able to grow the enterprise value of her small candy store and chocolate company to $10 million.

During the course of her business success, Kristina was plagued with the growing rampant homelessness in Seattle, and wanted to contribute towards a solution. She knew the problem was complex and involved a number of drivers beyond her control. Her interactions with different people were mixed and sometimes scary. She realized that many who were homeless had a history of trauma, substance abuse, and usually had some interaction with the foster care and criminal justice systems. She was particularly concerned about young children that were born into situations of homelessness and living in camping tents on the sidewalks. As she reflected on her own two children, it rattled her to imagine her own 8 year old boy living among drug needles and mental illness and without the comforts of safe housing or a stable income for the family.

Her compassion for the community instigated her to put 10% of the stock ownership of her business into a Donor Advised Fund (DAF), knowing that one day she would like to convert the commitment to cash and support her community. Sure enough, 6 months after she contributed 10% of her business to the DAF, she received a letter of intent (LOI) from a strategic business partner in Europe to purchase her small business for $10 million USD.

The larger European firm communicated that they would like to acquire her business for a number higher than her book value because it was a strategic acquisition for them. They had been loosely talking about it with Kristina for a long time and had enjoyed trade conferences together. Both firms were friendly with each other and shared a similar culture. The European firm loved Kristina's brand, custom packaging, and local distribution which seemed to be breaking records.

After some back and forth through her legal team, Kristina accepted the offer and sold her company for the full amount. As per the agreement, she was to work for the new owners for the next two years, thereby maintaining continuity of operations and hopefully revenues. Since she had a history of working with the new owners, she was agreeable to guarantee her employment to the new business ownership group over the next two years, which also provided a salary of $250,000 during the succession. The new owners were Swiss and wanted her to stay on as a brand ambassador, and as a local resource for the new foriegn owners. The European conglomerate was interested in retaining Kristina as a longer-term employee beyond the two year agreement and until the normal retirement age of 66 on an at-will basis.

Kristina was burdened with the responsibility of how to invest the $10 million, and was afraid that she might somehow make a mistake investing the funds or run out of money in her old age. She was also concerned that her children would not understand the value of what was created, and did not want to see her children become entitled to excessive luxuries. She had limited experience with the capital markets and investments prior to the sale, as most of her net worth was illiquid. Kristina was concerned that inflation might erode her assets, but she was also not comfortable with the volatility of the publicly traded stock market. In an effort to stimulate the economy, the Federal Reserve had been lowering interest rates for quite some time, and recently mentioned that they were planning to begin increasing interest rates the following year. With that in mind, Kristina knew that traditional bond investments would likely be fighting a headwind of rising interest rates over the coming years. She was further concerned about what the tax environment would look like in 22 years when she anticipated full retirement, as it seemed that both State and Federal governments were raising tax obligations to offset annual budget deficits and debt servicing. The federal government's unfunded obligations of Social Security, government pensions, and Medicare added further to her uncertainty about what future taxe rates might look like.

The allocation of the $10mm was approximately as follows:

- ➢ $1,000,000 to Donor Advised Fund for charitable grants to local non-profit organizations
- ➢ $1,800,000 to Federal Government for long term capital gains tax (20%)
- ➢ $342,000 to Federal Government for Affordable Care Act/Obamacare tax (3.8%)
- ➢ $630,000 to Washington State Government for long term capital gains tax (7%)
- ➢ $3,000,000 invested into long-term capital growth mandate to provide retirement income starting at age 65
- ➢ $3,228,000 invested in a short-term/intermediate-term to supplement earned income until age 65.

Assumptions:

- ➢ Total taxes paid to Federal and WA on business sale: $2,772,000
- ➢ Female, Super Preferred, Age 44, HNW, business owner, WA resident
- ➢ Husband Leif (age 46) is an electrician who will continue to work until age 68 and earns $120k per year (with 3% increases). Married with two children, ages 10 Annika and 8 boy Erikson
- ➢ Living needs are $22,000/mo. in today's dollars
- ➢ $500k in pre-tax qualified retirement account
- ➢ $100k cash in bank
- ➢ Current income of $240,000 per year with 3% increases.
- ➢ Existing life insurance policies with cash value of $150k in IUL (LTC provisions) from a Section 162 policy she took out 7 years ago at $2k/mo.
- ➢ Primary residence of $1mm (still owe $400k at 3.5% 30 year fixed)
- ➢ Owns a rental property worth $500k
- ➢ Retirement Income at age 65 of $22,000/mo. And adjust to private credit
- ➢ Inflation rate at 3%
- ➢ Life expectancy of 84 for both
- ➢ Today's tax rates, estate and income tax, federal and state (historical tax rates)
- ➢ PPLI allocation of diversified private equity (12% return) for first 21 years, then adjusted to alternative income (9% return) for remaining 19 years during retirement for a more conservative investment allocation

Kristina was feeling a bit overwhelmed about all the financial opportunities and pitfalls related to the business sale and the large payout. The only person that she felt comfortable talking to was the small business 401(k) advisor that she met through the state chamber of commerce retirement program. He had helped her establish a 401(k) plan seven years ago for the small candy and chocolate business. She had 15 employees at the time, and the multiple employer plan (MEP) structure allowed her to set up a plan at a below-market rate due to economies of scale. She had transferred her previous SEP IRA into the 401(k) plan and also added a Roth 401(k) component to the plan as well. Previously, she thought that her income was too high to qualify for contributions to a Roth, but realized those limitations were connected to the Roth IRA rather than the Roth 401(k). Her current gut feeling was that eventually the government would need to raise tax rates to offset the costs associated with a growing number of social programs and expenditures.

Her 401(k) advisor began discussing how her new situation would involve analysis and advisorship across tax, legal, and investment professionals. He discussed the value of a new "virtual family office" that brings together and orchestrates top-calibre professional advisors from across the nation through virtual technology to have collaborative planning sessions to benefit the business family. He also introduced some new concepts and key ingredients that he had observed among much wealthier families in their sophisticated planning arrangements. These ingredients combined the benefits of asset allocation with asset location in an effort to enhance Kristina's philanthropic ambitions as well as provide qualitative and quantitative support for her children, Annika and Erikson.

Kristoferson Estate Settlement at Kristina's passing age 84 (based on financial planning calculations and time series analysis):

Non-PPLI Taxable Estate: $64,604,163

- ➢ Primary residence - $2,845,847
- ➢ Investment real estate, Suncadia - $2,371,539
- ➢ Other life insurance - $711,461
- ➢ Post-sale investment account into diversified commercial real estate investment fund (revocable trust) - $32,608,717
- ➢ Side-fund investment account of extra unused income from PPLI and other sources for utilization of funds beyond normal monthly living expenses into diversified commercial real estate investment fund (to be transferred into revocable trust either before death or after death through a pourover will) - $26,066,555
- ➢ Retirement plan assets - $44
- ➢ ILIT - premiums paid for by revocable trust account (subject of future study)

PPLI Taxable Estate: $0 (zeroed out)

- ➢ **$91.7 million** projected income tax free death benefit includes repayment of loans related to annual distributions of $1mm at age 65 to age 84 to Kristina and Leif for living expenses
- ➢ **$23.4 million of $91.7 million** as federal estate exemption amount (current level) to be paid directly to South Dakota dynasty trust and initiate a new PPLI policy on Annika at her age 50 as the insured. (due to a mismatch of federal and state exemption amounts, a portion of the federal exemption amount may be subject to state death taxes depending on jurisdiction)
- ➢ **$68.3 million of $91.7 million** to Kristoferson Family Foundation: to zero out estate tax liability on death benefit proceeds and for maximum planned giving

Overall Estate Tax Liability of Total Inheritance:

- ➢ Washington State Estate Tax - **$16,852,233** (deduct exemption amount of $2,193,000. Then add $1,490,000 plus 20% of the taxable amount over $9,000,000)

- ➢ Washington State Estate Tax only on PPLI federal exemption amount (PPLI calculated first) - **$3,931,400** (deduct exemption amount of $2,193,000. Then add $1,490,000 plus 20% of the taxable amount over $9,000,000)
- ➢ Federal Estate Tax - **$18,908,252** (deduct State Estate Taxes paid of $16,852,233, then deduct exemption amount of $23,400,000, then pay $345,800 plus 40% of the amount over $1,000,000)
- ➢ Cumulative Washington State and Federal Estate Taxes - **$35,760,485**

Estate Tax Calculator: Washington State and Federal		
Non-PPLI Inheritance G1:	**$**	**64,604,163**
PPLI federal exemption amount transferred to dynasty trust as life insurance beneficiary:	**$**	**23,400,000**
PPLI death benefit proceeds to family foundation as life insurance beneficiary:	**$**	**68,309,501**
Stepped-up Inheritance Amount (pre-estate tax):	**$**	**88,004,163**
WA State Exclusion Amount	$	2,193,000
WA Estate Tax (lower brackets: below $9mm cumulative):	$	1,490,000
WA Estate Tax (20% of any amount over $9mm):	$	15,362,233
Total WA State Estate Tax:	**$**	**16,852,233**
Deduction for State Estate Tax:	$	16,852,233
Federal Estate Tax Exclusion Amount	$	23,400,000
Federal Estate Tax (lower brackets: below $1mm cumulative):	$	345,800
Federal Estate Tax (40% of any amount over $1mm):	$	18,562,452
Total Federal Estate Tax:	**$**	**18,908,252**
Total State and Federal Estate Taxes:	**$**	**35,760,485**
After-tax Amount of Inheritance to G2:	**$**	**52,243,678**

Final Kristoferson Estate Settlement (G1):

- ➢ Kristoferson Family Foundation or donor advised fund: **$68.3 million**
- ➢ Kristoferson Family Bank (dynasty trust)**: $23.4 million**
- ➢ Kristoferson Revocable Trust & Pourover Will (after estate taxes): **$52.2 million**
- ➢ Washington State Estate Taxes: **$16.8 million**
- ➢ Federal Estate Taxes: **$18.9 million**

(Optional) Irrevocable Life Insurance Trust: $35mm Death Benefit to Cover Estate Taxes

- ➢ Funded with annual gift exclusion amounts and additional cash flow from PPLI withdrawal of basis and loans
- ➢ Split-dollar construct to maximize death benefit and minimize premiums

Planned giving of Kristina Kristoferson Asset Location:

- ➢ Kristoferson Family Foundation or donor advised fund: **$68.3 million**
    - ○ Grants to non-profits that serve homeless families with children by providing child care and meals for the children while the parents are working or looking for work
    - ○ Vocational training programs - seeded a vocational school in Ballard that trained for electrical, plumbing, carpentry, fine cabinetry, glass installation, framing, welding, and concrete (the vocational school intentionally did not build a property, but rather leases an old church building in Ballard, and focuses on the operational costs of the training rather than paying down a building). The school provides classes on Mondays through Thursdays in the evenings only.
    - ○ Scholarships for homeless and impoverished individuals to receive vocational training through the new school

Annika and Erikson were feeling a little uncertain when their father passed away, and even more overwhelmed when their mother died. Both of their parents were distinguished leaders in the community, and they both enjoyed a longtime robust relationship with their parents. They were always there for them when they went through each life stage of childhood, adolescence, going to college, finding their first job, getting married, buying their first house, and having their first child. They felt that their parent's shoes were big ones to fill, and both Annika and Erikson didn't feel like they had any unusual gifts or talents. Their parents never pressured them to succeed at the expense of their relationships or personal health. They also made sure that they would have their retirement income secure and nursing care provided for in their vulnerable later years.

Annika and Erikson had seen the fruit of the good decisions that their parents made over their lifetimes and wanted to build on the momentum, rather than see it all dissipated. They had enjoyed the many conversations they had with their parents about helping the poor, and had witnessed the generosity of their parents first hand, both in giving and volunteering. Further, they had a commanding knowledge of real estate, as they had been going out to Suncadia for years to both enjoy the family investment property as well as to fix it up from time to time.

They may not be recorded in the history books for any notable accomplishments, but both Annika and Erikson followed their parent's example and invested heavily into their family relationships with their children and others. They involved their children in the family foundation's pursuit to distribute $68.3 million into local Ballard initiatives to serve the poor and create upward opportunities within their community. Each year, they would set aside time as a family to take a foundation vision trip and conduct a board meeting to discuss the prior year's grants and scholarships from the foundation and discuss opportunities ahead. This proved to be a special time for Annika and Erikson to involve their respective children in the family's philanthropic initiatives. Annika always cared for her health and she outlived Erikson in age, as she died at the age of 90, while Erikson died at the age of 88. Both Annika and Erikson were survived by their respective children, as they each had two.

Kristoferson G2 Estate Settlement at Annika passing age 90 (based on financial planning calculations and time series analysis):

Non-PPLI Taxable Estate of Annika and Erikson:

- ➢ Revocable trust beneficiary initial amount for Annika and Erikson of $26.1mm each to be utilized for current living expenses and additional for investment purposes with a focus on direct real estate ownership.
- ➢ Potential financial planning scenario of each child receiving $26.1mm at age 50 (Annika) and age 48 (Erikson) in addition to **$2.2mm distributions each per year** from the dynasty trust at ages 59 (Annika) and 57 (Erikson).
- ➢ Assumptions, 6% rate of return on taxable inheritance account invested in diversified commercial real estate investment fund (or direct real estate). Life expectancy for Annika (90) and Erikson (88).
- ➢ Immediate cost of living for both Annika and Erikson of $41,666 each. Cost of living expenses of $500k per year from investments in years prior to distributions from trust and for additional needs beyond trust distributions. Excess side funds are invested in real estate with a 6% rate of return (multi-family and industrial commercial real estate, income and growth).
- ➢ Annika's taxable estate from financial plan after living expenses and inflation adjustments for income: **$345,939,377**
- ➢ Erikson's taxable estate from financial plan after living expenses and inflation adjustments for income: **$345,939,377**

PPLI/Dynasty Trust Taxable Estate: $0 (no income tax, no estate tax)

- ➢ **$342,783,217** projected estate and income tax free death benefit at Annika age 90 from G2 PPLI policy to be paid directly to South Dakota dynasty trust for the benefit of **G3.**
- ➢ **$100,000,000** to Kristoferson Family Foundation (optional), thereby leaving **$242,783,217** in the dynasty trust for the benefit of Kristina's grandchildren.

- ➢ Tax free annual trust distributions (withdrawals of basis and loans) of **$4.4mm** to trust beneficiaries at Annika age 59-90 for living expenses - Total of **$136,400,000** tax-free income during lifetime

Estate Tax Liability of Annika and Erikson:

- ➢ Annika Washington State Estate Tax - **$68,439,275** (deduct exemption amount of $2,193,000. Then add $1,490,000 plus 20% of the taxable amount over $9,000,000)
- ➢ Annika Federal Estate Tax - **$101,447,521** (deduct State Estate Taxes paid of $45,776,443, then deduct exemption amount of $23,400,000, then pay $345,800 plus 40% of the amount over $1,000,000)
- ➢ Annika's after-tax estate: **$176,052,581** (revocable trust recommended to bypass probate and maintain privacy)
- ➢ Erikson Washington State Estate Tax - **$68,439,275** (deduct exemption amount of $2,193,000. Then add $1,490,000 plus 20% of the taxable amount over $9,000,000)
- ➢ Erikson Federal Estate Tax - **$101,447,521** (deduct State Estate Taxes paid of $45,776,443, then deduct exemption amount of $23,400,000, then pay $345,800 plus 40% of the amount over $1,000,000)
- ➢ Erikson's after-tax estate: **$176,052,581** (revocable trust recommended to bypass probate and maintain privacy)

Final Kristoferson Estate Settlement (G2 Combined):

- ➢ Kristoferson Family Foundation or donor advised fund: **$100,000,000**
- ➢ Kristoferson Family Bank (dynasty trust)**: $242,783,217**
- ➢ Annika and Erikson Revocable Trusts: ($176,052,581 x 2) = **$352,105,162**
- ➢ Washington State Estate Taxes: ($68,439,275 x 2) = **$136,878,550**
- ➢ Federal Estate Taxes: ($101,447,521 x 2) = **$202,895,042**

Planned giving and Tax Alpha from Kristoferson G2 Family Asset Location:

- ➢ Kristoferson Family Foundation or donor advised fund: **$100,000,000**
- ➢ Water projects in developing countries
- ➢ Native American vocational training projects

Annika's two daughters had a profound amount of respect for their mom. They had seen her diligently do her best to follow in their grandmother's footsteps, who now had a statue built in her honor for the care and generosity she showed towards the poor in the Ballard community. They had seen the weightiness of the responsibility of great wealth firsthand, and they reflected on the notion that wealth is like fuel. The fuel can be used for either good or ill purposes, and neutral in its existence. Erikson's two sons deeply respected their father and grandfather. After watching their dad take exceptional care of the small portfolio of rental properties, they realized how much they both enjoyed building and improving real estate. One of them became a plumber and the other an electrician, and they both enjoyed steady employment at reputable firms. They had a reputation between the two of them for trying to be the first one on the job, if any family real estate needed some attention. They found great delight and bonding together when they went on an annual camping and bow-hunting trip in the North Cascades.

They knew it was a much bigger responsibility than they had imagined, but with the passing of their parents, they now had $100 million to serve the poor. They felt fortunate that they were all four involved in the family office from the time they were young, and had a long track record of working together on family projects. Inside their hearts, they knew this new chapter was going to be the brightest yet and they were all excited to work together to serve the poor.

Generation 3 Starting Point: Endowment

- ➢ **Family bank** with trustees in South Dakota and **$242,783,217** for family wholeness and responsible management of wealth, distributed for purposes such as; preventative health, education, maintenance, support, property taxes, emergency and other medical expenses, private tuition, first home purchase, business seed capital, real estate acquisition capital, retirement security, graduate school, and professional development.
- ➢ Functioning **family office** with management oversight of family real estate portfolio, overall wealth reporting, and foundation assets
- ➢ **Family foundation** or donor advised fund with at least **$100 million** in assets (plus any residual amounts from G1 in addition)
- ➢ Direct inheritance across G3 of **$352,105,162**, although likely split between at least 4 children bringing the individual amount to **$88 million each** (if Annika had two children, and Erikson also had two children).

Some of the grandchildren of Kristina and Leif had the opportunity to travel abroad when they were in college as they both served in the Peace Corp. This gave them a perspective into the lack of opportunities in the developing nations, and made them grateful for the resources they were given to steward. They were especially concerned about how many children and families did not have access to clean water. They believed that clean water was a key ingredient to health, education, and broader economic development...and most importantly represented one of the most primal human needs. Further, they were saddened by the plight of the First Nations and the state of tribal lands, and they wanted to partner with indiginous educational efforts to provide additional vocational training and small business grants. In doing so, they wanted to create opportunities for other individuals to follow their grandmother's pathway of small business ownership that was responsible for the initial snowball that grew over three generations to an endowment that would be a watering hole for the family and for those in need.

APPENDIX E: MODEL ASSUMPTIONS, OUTPUTS, AND DISCLOSURES

H.1: Kristina Kristoferson Financial Plan

Gap Analysis Report

Prepared For **Kristina and Leif Kristoferson**

August 23, 2021

Prepared By **Kristofer Gray, CFP, C(k)P, CRPS, MPA**
Integrity Financial
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Data and Calculation Overview

Kristina's Data

Personal

Date of Birth	4/19/1977
Current Age	44 Years, 4 Months

Income

Gross Income per Paycheck	$20,000 Monthly
Estimated Annual Raise*	3%
Check Number for Raise	1

Retirement

Age to Retire	65
End of Month to Retire	January
Calculated Age*	65 Years, 9 Months
Calculated Date*	1/31/2043
Life Expectancy Method	Specify Age (84)

Social Security

Payments Start At	Retirement or 62 (Latter of)
Includes Survivor Benefits	No
Calculated Start Age	65 Years, 9 Months
Value Method	Calculate

The income for Social Security in retirement is estimated by the software. The actual value may vary significantly. A better estimate may be available from the Social Security Administration's web site.

Social Security income years:	35 or more
Subject to Windfall Elimination Provision	No
Percent of Calculated Value	100%

Kristina's Data

Retirement Plan Data

Retirement Plan	(No Plan)

Age and Date Calculations*

	Today	Retirement
Date	8/23/2021	1/31/2043
Kristina 's Age	44y 4m	65y 9m
Leif's Age	46y 4m	67y 9m
Kristina's Life Expectancy (Age)	84y	84y
Leif's Life Expectancy (Age)	84y	84y
Years until Retirement	21y 5m	

Leif's Data

Personal

Date of Birth	4/19/1975
Current Age	46 Years, 4 Months

Income

Gross Income per Paycheck	$10,000 Monthly
Estimated Annual Raise*	3%
Check Number for Raise	1

Retirement

Age to Retire	68
End of Month to Retire	January
Calculated Age*	68 Years, 9 Months
Calculated Date*	1/31/2044
Life Expectancy Method	Specify Age (84)

Leif's Data

Social Security

Payments Start At	Retirement or 62 (Latter of)
Includes Survivor Benefits	No
Calculated Start Age	68 Years, 9 Months
Value Method	Calculate

The income for Social Security in retirement is estimated by the software. The actual value may vary significantly. A better estimate may be available from the Social Security Administration's web site.

Social Security income years:	35 or more
Subject to Windfall Elimination Provision	No
Percent of Calculated Value	100%

Retirement Plan Data

Retirement Plan	(No Plan)

Age and Date Calculations*

	Today	Retirement
Date	8/23/2021	1/31/2044
Leif 's Age	46y 4m	68y 9m
Kristina's Age	44y 4m	66y 9m
Leif's Life Expectancy (Age)	84y	84y
Kristina's Life Expectancy (Age)	84y	84y
Years until Retirement	22y 5m	

Retirement Income

Gap Analysis Report | August 23, 2021 | Prepared for **Kristina Kristoferson** | Prepared by **Kristofer Gray, CFP, C(k)P, CRPS, MPA**

Data and Calculation Overview

Retirement Income

Inflation* 3%

Monthly Income Needed*

Incomes below are in today's dollars with increases from the appropriate inflation values above.

First retirement	$22,000
Both retired	$22,000
Survivor	$22,000

Retirement Investments

Side Fund / Additional Savings

TRAK will calculate the additional savings that is needed to meet the client's (and spouse's, when relevant) retirement goals. Additionally, any retirement income above the estimated need will be deposited into this account. Enter the anticipated rates of return for the additional savings.

Prior to Retirement*	6%
During Retirement*	6%
Annual Increase Kristina's with Raise	Yes

Retirement Investments

Chase Bank - Cash Alternative

Owner	Kristina
Balance	$100,000
Pre-Retirement Rate of Return*	1%

Contributions

Account Type for Contribution Limits	None

Contributions: Contributes a mandatory 0%.

Retirement Distributions

Required Minimum Distribution	None
Payout Method	Use Funds as Needed
Retirement Rate of Return*	1%
Start Distributions	At Retirement

Retirement Investments

Chocolate Co. - Qualified Reti

Owner	Kristina
Balance	$500,000
Pre-Retirement Rate of Return*	7%

Contributions

Account Type for Contribution Limits	401(k)

Participant contributions are limited to $19,500 with an additional $6,500 of contribution allowed when the participant is age 50 or over. The total combined employee and employer contributions may not exceed $58,000. Base year for limits is 2021.

Contributions: Contributes a mandatory 0% and the maximum allowable contribution, and in a year change the contributions to stop making contributions to the account.

Retirement Distributions

Required Minimum Distribution	None
Payout Method	Amortize with Inflation
Retirement Rate of Return*	7%
Start Distributions	At Retirement

Gap Analysis Report | August 23, 2021 | Prepared for **Kristina Kristoferson** | Prepared by **Kristofer Gray, CFP, C(k)P, CRPS, MPA**

Data and Calculation Overview

Retirement Investments

AIG Cash Value Life Insurance

Owner	Kristina
Balance	$150,000
Pre-Retirement Rate of Return*	4%

Contributions

Account Type for Contribution Limits	None

Contributions: Contributes a mandatory 0%.

Retirement Distributions

Required Minimum Distribution	None
Payout Method	Use Funds as Needed
Retirement Rate of Return*	4%
Start Distributions	At Retirement

Primary Residence - Home Equit

Owner	Kristina
Balance	$600,000
Pre-Retirement Rate of Return*	4%

Contributions

Account Type for Contribution Limits	None

Contributions: Contributes a mandatory 0%.

Retirement Distributions

Required Minimum Distribution	None
Payout Method	Use Funds as Needed
Retirement Rate of Return*	4%
Start Distributions	At Retirement

Retirement Investments

Chocolate Co. - Investment Acc

Owner	Kristina
Balance	$3,228,000
Pre-Retirement Rate of Return*	6%

Contributions

Account Type for Contribution Limits	None

Contributions: Contributes a mandatory 0%.

Retirement Distributions

Required Minimum Distribution	None
Payout Method	Use Funds as Needed
Retirement Rate of Return*	6%
Start Distributions	At Retirement

Suncadia Investment (Equity)

Owner	Kristina
Balance	$500,000
Pre-Retirement Rate of Return*	4%

Contributions

Account Type for Contribution Limits	None

Contributions: Contributes a mandatory 0%.

Retirement Distributions

Required Minimum Distribution	None
Payout Method	Use Funds as Needed
Retirement Rate of Return*	4%
Start Distributions	At Retirement

Known Incomes

PPLI Diversified Private Equit

Owner	Client

Payment Information

Payments per Year	1
Income Stream Value	$1,000,000

Rate of Increase/Inflation

Annual COLA*	0%
Compound Increase	No

Income Period

Starting Method	Owner's Age
Starting Value*	65
Starting Date*	2/28/2043
Ending Method	Owner Death
Ending Date*	4/30/2061

Projected Retirement Balances

Data and Calculation Overview

Projected Retirement Balances

Retirement Investments

Chase Bank - Cash Alternative

Potential Retirement Value	$123,785

Chocolate Co. - Qualified Reti

Potential Retirement Value	$2,215,131

AIG Cash Value Life Insurance

Potential Retirement Value	$347,817

Primary Residence - Home Equit

Potential Retirement Value	$1,391,270

Chocolate Co. - Investment Acc

Potential Retirement Value	$11,261,295

Suncadia Investment (Equity)

Potential Retirement Value	$1,159,392

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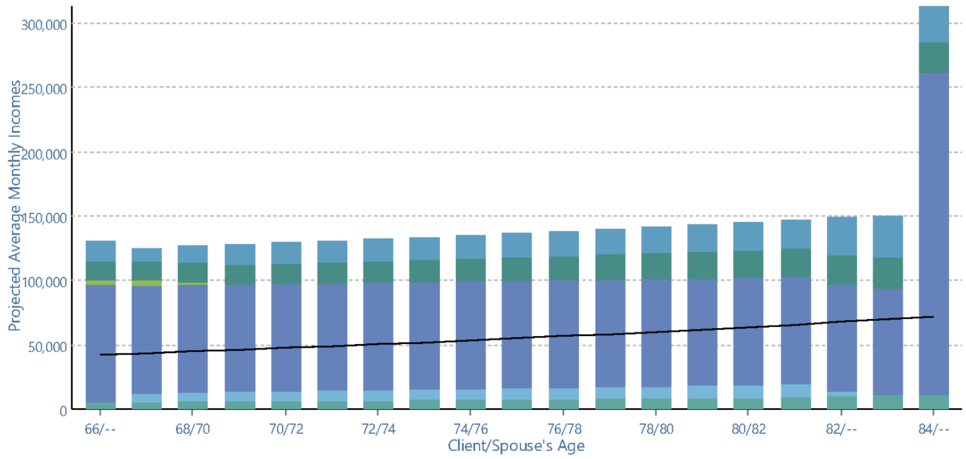
Retirement Years Income



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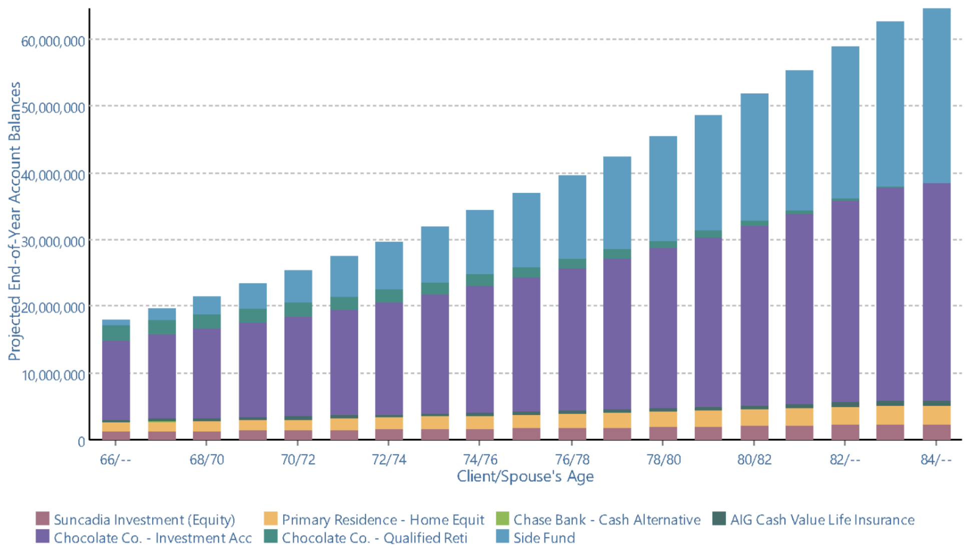
Account Balances During Retirement



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The hypothetical examples are developed using information you provide, assumptions you agree to and other publicly available data, including plan specific data where applicable. It is not intended to reflect the performance of any specific product or account and is not intended to predict actual results. Your actual results may differ from the projected values contained in this report. Assumed rates will vary over time, particularly for long-term investments. Investments offering the potential for higher rates of return also involve a higher degree of risk to principle. The investment return and principal value of an investment will fluctuate with market conditions. There are numerous factors that can affect the actual outcome and, therefore, you should review this information periodically and determine its appropriateness. The projected values do not reflect the deductions of any fees and charges associated with a mutual fund, fixed, indexed or variable annuity product; and if so, returns would have been lower.

The tax calculations in the Report are not intended to be actual calculations of the tax due for any year. The tax calculations may use a flat tax rate, which may not reflect your actual marginal tax rate or your actual average tax rate, and the calculations may not take into account your particular deductions, exemptions, and credits.

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The calculation of retirement benefit amounts under social security is complicated and subject to change. Social security retirement benefits may be reduced when an individual also receives a benefit from a retirement plan maintained by a state or local government. The software does not calculate this reduction, and it may not be reflected in the report.

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H.2: Annika Kristoferson Financial Plan

Gap Analysis Report

Prepared For **Annika Kristoferson**

August 23, 2021

Prepared By

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Data and Calculation Overview

Annika's Data

Personal

Date of Birth	4/19/1971
Current Age	50 Years, 4 Months

Income

Gross Income per Paycheck	$0 Monthly
Estimated Annual Raise*	3%
Check Number for Raise	1

Retirement

Age to Retire	50
End of Month to Retire	January
Calculated Age*	50 Years, 9 Months
Calculated Date*	1/31/2022
Life Expectancy Method	Specify Age (90)

Social Security

Payments Start At	Retirement or 62 (Latter of)
Calculated Start Age	62 Years, 1 Month
Value Method	Calculate

The income for Social Security in retirement is estimated by the software. The actual value may vary significantly. A better estimate may be available from the Social Security Administration's web site.

Social Security income years:	35 or more
Subject to Windfall Elimination Provision	No
Percent of Calculated Value	100%

Retirement Plan Data

Retirement Plan	(No Plan)

Annika's Data

Age and Date Calculations*

	Today	Retirement
Date	8/23/2021	1/31/2022
Annika 's Age	50y 4m	50y 9m
Annika's Life Expectancy (Age)	90y	90y
Years until Retirement	0y 5m	

Retirement Income

Inflation*	3%

Monthly Income Needed*

Income below is in today's dollars with increases from the appropriate inflation values above.

Income need	$41,666

Retirement Investments

Side Fund / Additional Savings

TRAK will calculate the additional savings that is needed to meet the client's (and spouse's, when relevant) retirement goals. Additionally, any retirement income above the estimated need will be deposited into this account. Enter the anticipated rates of return for the additional savings.

Prior to Retirement*	6%
During Retirement*	6%
Annual Increase Annika's with Raise	No

Retirement Investments

Taxable Inheritance Account

Balance	$26,100,000
Pre-Retirement Rate of Return*	6%

Contributions

Account Type for Contribution Limits	None

Contributions: Contributes a mandatory 0%.

Retirement Distributions

Required Minimum Distribution	None
Payout Method	Use Funds as Needed
Retirement Rate of Return*	6%
Start Distributions	At Retirement

Known Incomes

Data and Calculation Overview

Known Incomes

Dynasty Trust w PPLI

Payment Information

Payments per Year	1
Income Stream Value	$2,200,000

Rate of Increase/Inflation

Annual COLA*	0%
Compound Increase	No

Income Period

Starting Method	Owner's Age
Starting Value*	59
Starting Date*	4/30/2030
Ending Method	Owner Death
Ending Date*	4/30/2061

Projected Retirement Balances

Retirement Investments

Taxable Inheritance Account

Potential Retirement Value	$26,783,797

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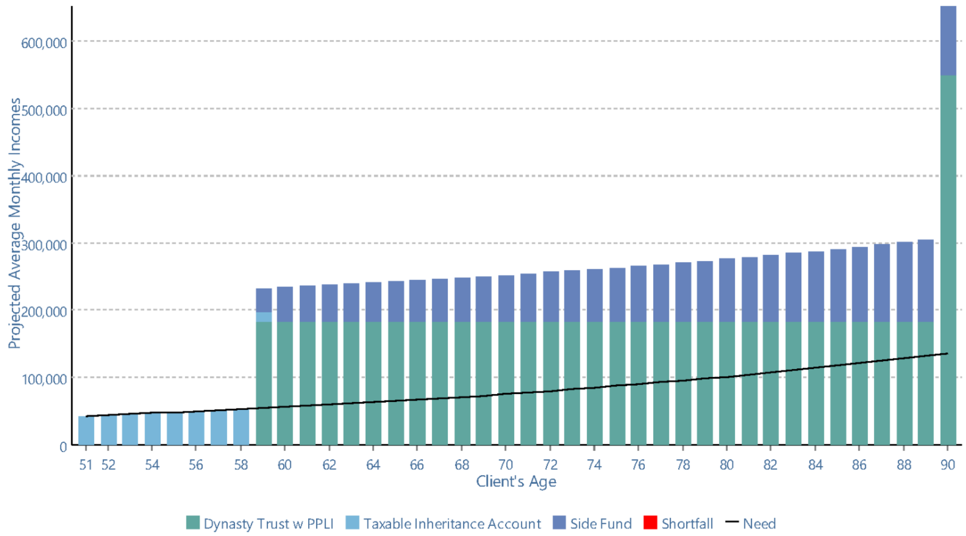
Retirement Years Income



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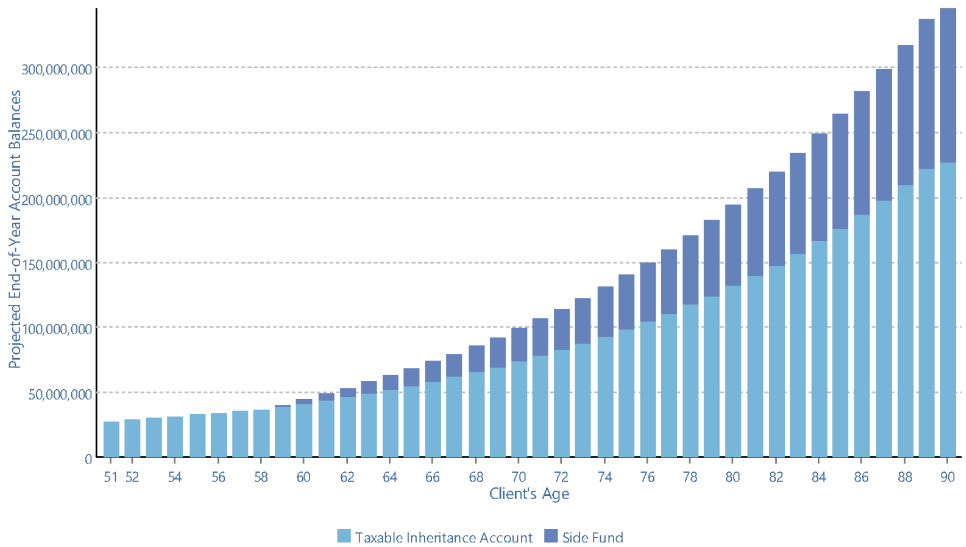
Account Balances During Retirement



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H.3: Erikson Kristoferson Financial Plan

Gap Analysis Report

Prepared For **Erikson Kristoferson**

August 23, 2021

Prepared By **Kristofer Gray, CFP, C(k)P, CRPS, MPA**

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p: 1-800-794-4015

Data and Calculation Overview

Erikson's Data

Personal

Date of Birth	4/19/1973
Current Age	48 Years, 4 Months

Income

Gross Income per Paycheck	$0 Monthly
Estimated Annual Raise*	3%
Check Number for Raise	1

Retirement

Age to Retire	48
End of Month to Retire	January
Calculated Age*	48 Years, 9 Months
Calculated Date*	1/31/2022
Life Expectancy Method	Specify Age (88)

Social Security

Payments Start At	Retirement or 62 (Latter of)
Calculated Start Age	62 Years, 1 Month
Value Method	Calculate

The income for Social Security in retirement is estimated by the software. The actual value may vary significantly. A better estimate may be available from the Social Security Administration's web site.

Social Security income years:	35 or more
Subject to Windfall Elimination Provision	No
Percent of Calculated Value	100%

Retirement Plan Data

Retirement Plan	(No Plan)

Erikson's Data

Age and Date Calculations*

	Today	Retirement
Date	8/23/2021	1/31/2022
Erikson 's Age	48y 4m	48y 9m
Erikson's Life Expectancy (Age)	88y	88y
Years until Retirement	0y 5m	

Retirement Income

Inflation*	3%

Monthly Income Needed*

Income below is in today's dollars with increases from the appropriate inflation values above.

Income need	$41,666

Retirement Investments

Side Fund / Additional Savings

TRAK will calculate the additional savings that is needed to meet the client's (and spouse's, when relevant) retirement goals. Additionally, any retirement income above the estimated need will be deposited into this account. Enter the anticipated rates of return for the additional savings.

Prior to Retirement*	6%
During Retirement*	6%
Annual Increase Erikson's with Raise	Yes

Retirement Investments

Taxable Inheritance Account

Balance	$26,100,000
Pre-Retirement Rate of Return*	6%

Contributions

Account Type for Contribution Limits	None

Contributions: Contributes a mandatory 0%.

Retirement Distributions

Required Minimum Distribution	None
Payout Method	Use Funds as Needed
Retirement Rate of Return*	6%
Start Distributions	At Retirement

Known Incomes

Data and Calculation Overview

Known Incomes

Dynasty Trust w PPLI

Payment Information

Payments per Year	1
Income Stream Value	$2,200,000

Rate of Increase/Inflation

Annual COLA*	0%
Compound Increase	No

Income Period

Starting Method	Owner's Age
Starting Value*	57
Starting Date*	4/30/2030
Ending Method	Owner Death
Ending Date*	4/30/2061

Projected Retirement Balances

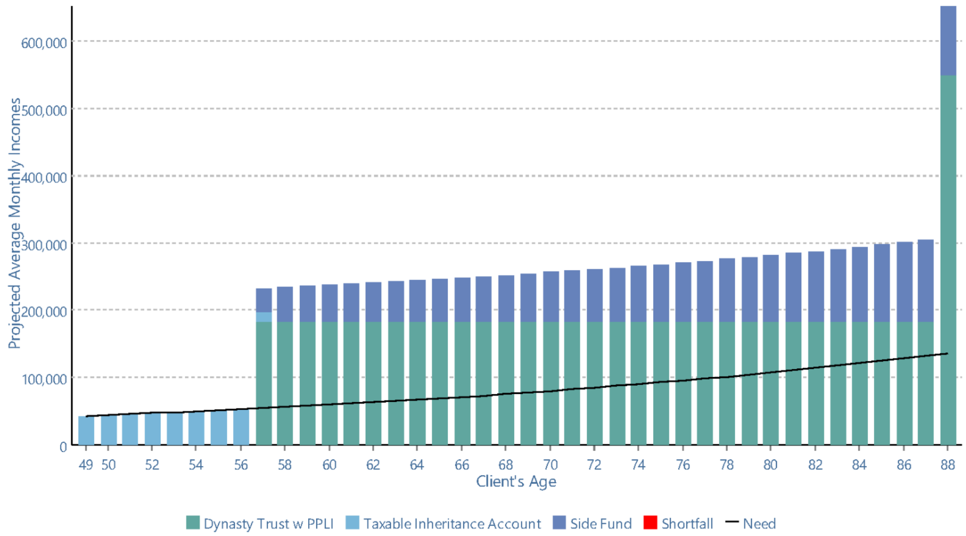
Retirement Investments

Taxable Inheritance Account

Potential Retirement Value	$26,783,797

*- Rates of return are hypothetical and are not for predicting performance or imply that past performance will reoccur. These figures are estimates only and are based on information provided by you and do not represent guaranteed returns by your retirement system, Social Security, or any other source. Actual values may be significantly different. Required minimum distribution (RMD) rules applicable to qualified plans may apply. Taxation is not taken into consideration. You should consult with your tax advisor to determine the impact taxes and RMD rules may have on your particular situation. You should contact your retirement system benefits office for an official projection of your pension income and all available income options.

Retirement Years Income



Illustrated values are projected from data provided by the client in the "Client Data and Calculation Overview" pages.

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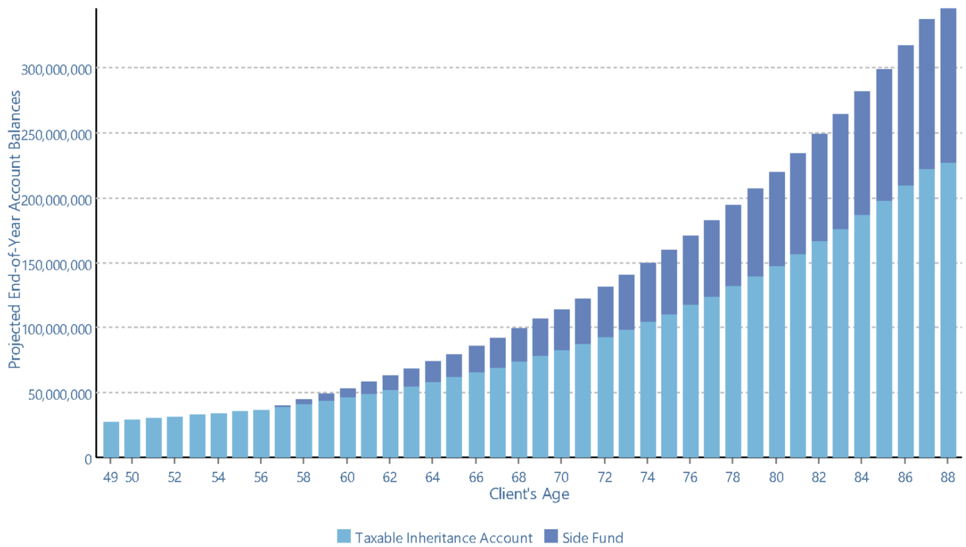
Account Balances During Retirement



Illustrated values are projected from data provided by the client in the "Client Data and Calculation Overview" pages.

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The hypothetical examples are developed using information you provide, assumptions you agree to and other publicly available data, including plan specific data where applicable. It is not intended to reflect the performance of any specific product or account and is not intended to predict actual results. Your actual results may differ from the projected values contained in this report. Assumed rates will vary over time, particularly for long-term investments. Investments offering the potential for higher rates of return also involve a higher degree of risk to principle. The investment return and principal value of an investment will fluctuate with market conditions. There are numerous factors that can affect the actual outcome and, therefore, you should review this information periodically and determine its appropriateness. The projected values do not reflect the deductions of any fees and charges associated with a mutual fund, fixed, indexed or variable annuity product; and if so, returns would have been lower.

The tax calculations in the Report are not intended to be actual calculations of the tax due for any year. The tax calculations may use a flat tax rate, which may not reflect your actual marginal tax rate or your actual average tax rate, and the calculations may not take into account your particular deductions, exemptions, and credits.

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APPENDIX F: GLOSSARY OF TERMS

Description of key theories, concepts, ideas

a. **<u>Endowment</u>** - An endowment is a donation of money or property to a non-profit organization, which uses the resulting investment income for a specific purpose. "Endowment" can also refer to the total of a non-profit institution's investable assets, also known as "principal" or "corpus," which is meant to be used for operations or programs that are consistent with the wishes of the donor. Most endowments are designed to keep the principal amount intact while using the investment income for charitable efforts.

b. **<u>Reverse Endowment Model</u>** - A fixed future testamentary tax-free financial capitalization of a family bank and/or philanthropic gift, that one is utilizing the potential growth and tax-free income during their lifetime for a long-term impact pre-and-post mortality. It is a self-completing plan if the insured dies prematurely, by way of guaranteeing the principal necessary to capitalize the fixed future contributions. The future principal remains in tact, while the income realized during one's lifetime is variable and dependent upon investment performance, which is why private equity and direct global real estate are ideal asset classes to hedge market risk, jurisdictional risk, and currency/inflation risk.

c. **<u>High Net-Worth</u>** - High net-worth individual is a term used by some segments of the financial services industry to designate persons whose investable assets exceed a given amount. Typically, these individuals are defined as holding financial assets with a value greater than US$1 million.

d. **Ultra-High Net-Worth** - Ultra-high net-worth individuals (UHNWI) are defined as people with investable assets of at least $30 million, usually excluding personal assets and property such as a primary residence, collectibles and consumer durables.

e. **Accredited Investor** - Accredited investors must meet one of two income requirements, according to the U.S. Securities & Exchange Commission (SEC): 1) A net worth of at least $1 million (excluding the value of one's primary residence); or 2) Income of at least $200,000 each year for the last two years (or $300,000 combined income if married) with an expectation to earn the same amount in the current calendar year. (sec.gov)

f. **Qualified Purchaser** - This is a term defined by the U.S. Securities and Exchange Commission (SEC). Investors must meet one of the four following criteria to be considered a qualified purchaser: 1) an individual or family-owned business that owns $5 million or more in investments, 2) a trust sponsored and managed by qualified purchasers, 3) an individual or entity that invests at least $25 million, either for their own accounts or on others' behalf, 4) any other entity, if all owners are qualified purchasers.

g. **A Family Bank** is a trust combined with a limited liability company (LLC). This allows assets to survive multiple generations without estate taxes by lending money to heirs. It allows family members to access capital at preferential interest rates and more liberal underwriting to help family members with loans for:

   i. Business capitalization

   ii. Career development

iii. Real estate acquisition

iv. Medical emergencies

v. It is also an excellent tool to pay ongoing taxes and insurance costs on family vacation properties. It is also an excellent tool to protect from children's creditors or rogue spouses.

h. **A Family Foundation** - The Council on Foundations defines a family foundation as one whose funds are derived from members of a single family, though this is not a legal term and has no precise definition. The Council on Foundations suggests that family foundations have at least one family member serving as an officer or board member of the foundation and, as the donor, that individual (or a relative) must play a significant role in governing and/or managing the foundation. Most family foundations are run by family members who serve as trustees or directors on a voluntary basis. In many cases, second- and third-generation descendants of the original donors manage the foundation. Family foundations make up over half of all private (family, corporate, independent, and operating) foundations, or 40,456 out of approximately 73,764 foundations (Foundation Center, 2011). Family foundations range in asset size from a few hundred thousand dollars to more than $1 billion. The holdings of family foundations total approximately $294 billion, or about 44 percent of all foundation holdings of $662 billion.

i. **Trustee Services** - A trustee is a person or firm that holds and administers property or assets for the benefit of a third party. A trustee may be appointed for a wide variety of purposes, such as in the case of bankruptcy, for a charity, for a trust fund or for certain types of retirement plans or pensions.

j. **Private Placement Life Insurance** - a form of cash value universal life insurance that is offered privately, rather than through a public offering.

k. **Private Equity** - Private Equity should be seen as an investment that consistently yields some of the highest returns. As a registered investment advisor, one of my preferred tools for creating significant wealth outside of leveraged real estate and the family business are private equity funds. Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of the public equity. In layman's terms, it is money invested in privately owned businesses that are not publicly traded on the stock market. Generally speaking, these funds are not correlated to the stock markets, or the turbulence of the market oftentimes centered in misguided behavioral finance of the masses (fear or greed). Shifting investments from market risk to manager risk can be highly effective when world-class managers are engaged. Two of the common drawbacks of private equity investments are capital calls (requests for more money, oftentimes requiring the investor to keep excessive cash on the sidelines earning minimal interest) and tax inefficiencies of the entity holding the investment….both of which can be eliminated with professional guidance. Although there is generally a higher risk involved, the potential returns can be quite generous if structured properly.

l. **Single Family Office**: a corporate entity and formal organization oftentimes staffed with non-family employees that historically provides services such as;

day-to-day accounting and payroll activities, management of legal affairs, family management services, which includes family governance, financial and investment education, philanthropy coordination, succession planning, property management, managing household staff, making travel arrangements, and managing investments and trusts for a single family. A family office can cost over $1 million a year to operate, so the family's net worth usually exceeds $100 million in investable assets. In general, a single family office serves between 4-6 households and is staffed with 8-11 professionals. In practice, there is a common understanding that a Single Family Office is an organization that serves multiple households across one or more generations that are bound together by family ties.

m. **<u>Tax Alpha:</u>** The additional increase of a family's net worth through legitimate tax planning and asset location techniques. In the investment arena, alpha is used to describe the extra performance that a manager can skillfully generate to outperform ordinary market returns. Similarly, tax alpha through proper asset location can add significantly to a family's net worth and planned giving by utilizing and optimizing sound tax strategies across all available options.

n. **<u>Family CFO:</u>** The duties of a Family CFO are centered around managing capital calls, directing cash flow, and overseeing financial planning across all entities and assets, while proposing corrective actions to optimize family wealth and minimize tax liabilities. A Family CFO operates from a "balance sheet perspective" looking primarily at the family balance sheet as their starting point for building and maintaining the financial infrastructure across all trusts, business ventures, real estate assets, investment accounts, qualified plans, donor advised funds, family foundations, irrevocable trusts and other structures. The Family CFO is also responsible for drafting and adhering to the family office Investment Policy Statement, which can set the parameters for asset allocation, asset liquidity, and asset location. The investment policy statement delivers an objective and intelligent approach to an investment thesis and may be less susceptible to emotional or irrational investment maneuvers. Finally, the Family CFO acts as a “quarterback” or “general contractor” among other professional advisors including but not limited to; CPAs/accountants, bookkeepers, insurance brokers, asset managers, estate attorneys, real estate professionals, business attorneys, controllers/business managers, private bankers, and outside philanthropic contacts. This coordinated effort can deliver a more intelligent and informed decision making process on behalf of the family in relation to the family wealth.

o. **Business Risk:** Exposure to anything that threatens a business’ ability to achieve its financial goals, or contributes to lower profits, or causes financial collapse of the company.

p. **Market Risk:** The risk of price volatility on the public market, or the risk of a decline in the value of a security or a portfolio.

q. **Inflation Risk:** The risk that inflation will silently work against or eclipse the actual purchasing power of a portfolio or an investment’s return.

r. **Liquidity Risk:** The risk that an individual or a family will not be able to meet cash flow obligations, capital call commitments, or short-term debt obligations due to illiquidity of assets or investments.

s. **Jurisdictional Risk:** the risk that changing regulatory, political, or legal factors could impede a business or investment within a specific jurisdiction.

t. **Interest Rate Risk:** The risk of investment losses of a bond or other fixed-rate investments that result from a change in interest rates.

u. **Tax Risk:** The risk that tax rates will change unfavorably and result in losses and less family wealth due to higher than expected taxes.