MassMutual
Strategic Distributors

SUCCESS STRATEGIES
Advanced Sales

Low Rates & Intra-Family Loans

Planning for High Net Worth Families

High net worth (HNW) families can take advantage of currently low interest rates to complete their wealth transfer planning and address their life insurance needs.

Loans vs. Gifts. In a nutshell, HNW families can lend cash — or sell an asset — to their heirs, or to a family trust for their benefit. **Because the loans must be repaid, they are not taxable gifts.** By making loans, parents have tremendous flexibility depending on changing circumstances and tax law because the loan can be:

- **repaid**
- **refinanced**
- **forgiven later**

Note that when a loan is forgiven, it is then a completed gift. As such, the amount of forgiveness is taxable, in which case gift or estate taxes on the amount of forgiveness is due. However, the lifetime gift and estate tax exemption can be used to cover the taxes, if available.[1]

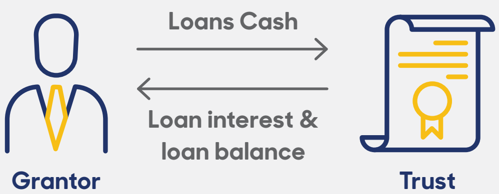
[1] The lifetime gift and estate tax exemption amount in 2022 is $12.06M per person/$24,120M per couple and is subject to indexing. The current exemption amount is due to expire in 2026 — when it reverts to its 2017 level — roughly $6M per person/$12M per couple, subject to retroactive adjustments for inflation.

Loans

An intra-family loan approach offers families the luxury of time to decide when and if to make permanent gifts without having to delay planning.

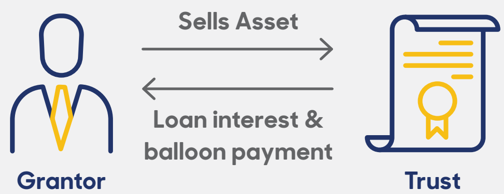
SCENARIO A.

Loan of Cash
Lump sum or annual loans
to fund premiums



SCENARIO B.

Sale of Asset
Sell income-producing asset,
the income of which funds premium



Scenario A. Annual loans of cash are made by the grantor (mom or dad) to an Irrevocable Life Insurance Trust (ILIT). The loans can then be used by the trustee to pay annual insurance premiums. Alternatively, a lump-sum loan can be made to the trust from which the trustee pays life insurance premiums annually. Loan interest is paid to the grantor annually (or accrued). The loan is repaid from trust assets, the policy death benefit, or cash values, where available.

Scenario B. An income-producing asset can be sold to an ILIT in exchange for an installment note sale. The asset's income is used to fund annual premiums on a life insurance policy, as well as annual loan interest. A balloon payment of principal at the end of the loan term is made from trust assets, including the asset that was sold, if the trust allows.

Growth

The AFR Rate. The Applicable Federal rate (AFR) published monthly by the government is used to determine loan interest in private loan arrangements between a grantor and the trust. The loan interest can be accrued or paid annually.

Fair Market Loan. For a loan to be considered an arm's length transaction, the IRS requires a fair market rate of interest be charged. The government AFR rates are considered fair rates of interest. The AFR rate can be locked in for the term of the loan at the time the loan is established:

- **Short-term AFR** rate is used for loans less than 3 years.
- **Mid-term AFR** rate is used for loans with a term of 3-9 years.
- **Long-term AFR** rate is used for loans of more than 9 years.

Chart A below illustrates a combination of assumed gross rates of return on trust assets and the mid-term AFR rates (used for loans that are 3-9 years in duration).

- The difference between the return (often referred to as "arbitrage") and the AFR rate is what could be available to fund life insurance premiums.[2]
- For context, note the relatively high AFR rates in July 1998 and 1999 and the resulting lack of arbitrage, compared to the current low AFR rates. Low AFR rates are what make intra-family loans an attractive wealth transfer tool.

Chart A

ASSUMING 4% GROWTH RATE			ASSUMING 6% GROWTH RATE			ASSUMING 8% GROWTH RATE		
Monthly AFR	Mid-Term AFR Rate	Potential Arbitrage	Monthly AFR	Mid-Term AFR Rate	Potential Arbitrage	Monthly AFR	Mid-Term AFR Rate	Potential Arbitrage
Jan '22	**1.30%**	**2.70%**	**Jan '22**	**1.30%**	**4.70%**	**Jan '22**	**1.30%**	**6.70%**
Jan '19	2.89%	1.11%	Jan '19	2.89%	3.11%	Jan '19	2.89%	5.11%
Jan '98	5.93%	-1.93%	Jan '98	5.93%	0.07%	Jan '98	5.93%	2.07%
Jan '88	8.81%	-4.81%	Jan '88	8.81%	-2.81%	Jan '88	8.81%	-0.81%

6% RETURN - 1.30% LOAN INTEREST = 4.70% LEFT TO FUND INSURANCE

Chart A assumes the use of a "Grantor Trust" so that tax on annual trust earnings are paid by the grantor and not the trust, leaving more in the trust to do planning. Trusts should be drafted by an attorney familiar with such matters.

Life Insurance

Where does life insurance fit in?

Low rates mean there can be more funds available from the trust's rate of return, net of the loan interest payments, to fund the life insurance need.

Although there is a need for a large life insurance policy, clients may not be ready to permanently part with large sums of cash to pay premium. In the right circumstances, making a loan to a family trust offers flexibility and time to decide, if and when to make gifts without having to delay planning.

- The loans can be made annually in the amount of the premium.
- Alternatively, the loan can be made in a lump-sum to the trust.

Lump-Sum Loans. When a lump-sum loan is used, the solve for the lump sum loan amount is based on the projected trust growth over the loan term. The more growth that can support the premiums, the lower the upfront loan amount required. Likewise, the lower the AFR rate, the more funds available to pay premiums. Note that the lump-sum loan may also include the repayment of principal.

Chart B below considers the lump-sum loan required to support 9 annual premiums of $100,000 on a hypothetical policy. The lump sum loan required — back in years 2000 and 2007, respectively, when AFR rates were higher — assuming a 6% trust rate of return, are notably higher than the loan required today:

- In December 2000 there is negative arbitrage, meaning that the lump-sum loan required is **0.21% more** than the 6% return supports to fund all premiums.
- Compare this to the **excess 4.70%** available in January 2022, which decreases the principal amount of the loan by roughly $457,287 compared to December 2000.
- The loan interest is paid annually based on the mid-term AFR rate for 9-year notes.
- The trust is assumed to be drafted as a Grantor Trust, which allows the trust income taxes to be paid by the grantors, leaving more in the trust to do planning.

Chart B

ASSUMING 6% GROWTH RATE			
Monthly AFR	**Mid-Term AFR Rate**	**Potential Arbitrage**	**Lump Sum Required**
Dec 2000	6.21%	-0.21%	$1,248,201
Dec 2007	4.58%	1.42%	$1,047,201
Jan '22	1.30%	4.70%	**$790,914**

Chart C below illustrates the lump-sum loan required to fund a $5M Whole Life 20 Pay policy with $157,150 annual premium outlay for 13 years, assuming 6% growth of the funds. The loan interest assumes a locked rate of 1.30% based on the January 2022 AFR rate for loans up to 9 years. It is assumed that the loan is refinanced for an additional 4 years at a 3% AFR rate. The loan is repaid in year 40, age 87 using the policy's non-guaranteed values, if not repaid before with death proceeds. Alternatively, other trust assets can repay the loan, if available. The loan can also be forgiven. When the loan is forgiven it may be subject to gift or estate tax if there is not a sufficient amount of lifetime gift or estate tax exemption to shelter it.

Chart C

LUMP-SUM LOAN TO IRREVOCABLE LIFE INSURANCE TRUST (ILIT) TO FUND PREMIUM								
					NON-GUARANTEED VALUES			
Year	Age	Lump-Sum Loan to Trust	Annual Premium Outlay	Loan Interest*	Loan Repayment from Policy Cash Values	Net Cash Value End Year	Net Death Benefit End Year	IRR on Death Benefit
	47	**$1,734,809**						
1	48	-	$157,150	$22,553	-	$53,700	$5,059,874	3119.00%
5	52	-	$157,150	$22,553	-	$590,800	$5,310,580	72.28%
10	57	-	$157,150	$52,044	-	$1,520,235	$5,730,409	22.73%
13	60	-	$157,150	$52,044	-	$2,218,320	$6,124,061	14.82%
15	62	-	-	-	-	$2,422,296	$5,812,165	11.33%
20	67	-	-	-	-	$3,045,748	$5,206,853	6.69%
25	72	-	-	-	-	$3,958,276	$6,071,441	5.78%
30	77	-	-	-	-	$5,108,674	$7,096,268	5.25%
35	82	-	-	-	-	$6,525,453	$8,299,252	4.89%
40	87	-	-	-	**$1,734,809**	$6,410,283	$7,578,331	4.55%

*The above example assumes locking in the January 2022 mid-term AFR rate of 1.30% for the first 9 years, after which the loan is assumed to be refinanced at 3% for years 10-13.

Chart C assumes a $5M Whole Life 20 Pay policy on a Female, Age 47, Ultra-Preferred Non-Tobacco risk. The trust pays annual premium of $157,150 for 13 years from the lump-sum loan. It is assumed that premiums due for years 14-20 are paid from the surrender of paid-up additions. Chart C is a supplemental illustration that is not valid unless accompanied by the **basic illustration**. Refer to the basic illustration for assumptions, explanations, guaranteed elements and additional information. The values shown here are taken from the current assumption of non-guaranteed values. They include dividends, which are neither estimates nor guarantees, that have been applied to purchase paid-up additions based on the 2022 dividend schedule. The dividend schedule is reviewed annually, and it is likely that dividends in future years will be lower or higher depending on the Company's actual experience.

Contact Advanced Sales at **1-800-601-9983 Option #2**
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