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Strategic Distributors

SUCCESS STRATEGIES
Advanced Sales

Intra-Family Loans

Planning for High Net Worth Families

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**[1]

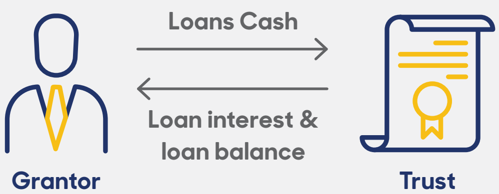
Use it or Lose It. The lifetime gift and estate tax exemption amount in 2023 is $12.92M per person/$25.84M per couple and is subject to indexing. The current exemption amount is due to expire in 2026 – when it reverts to its 2017 level – roughly $6.8M per person/$13.6M per couple, subject to retroactive adjustments for inflation. Therefore, under current law, a wealthy individual can give away (either during lifetime or at death) approximately $6.12M more without gift taxes through 2025. A wealthy couple can give away $12.2M more. This means that if parents make a loan today and decide to forgive the loan before 2026, they can utilize the excess exemption before it expires.

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.

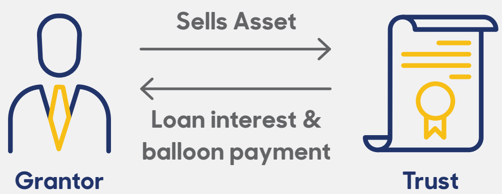
SCENARIO A.

Loan of Cash
Lump sum or annual loans
to fund premiums



SCENARIO B.

Installment Note Sale
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 can be made from trust assets. If the trust allows, the asset that was sold to the trust can also be used to repay the loan principal.

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.

Where does life insurance fit in?

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.

Life Insurance

Chart C below illustrates the lump-sum loan required to fund a $5M Whole Life 20 Pay policy on a male, age 47, ultra-preferred non-tobacco underwriting class with $170,700 annual premium outlay for 13 years, assuming 8% growth of the funds. It is assumed that premiums due for years 14-20 are paid from the policy through surrender of paid up additions.[2] The loan interest assumes a locked rate of 3.85% based on the January 2023 long-term AFR rate for notes beyond 9 years. The loan is repaid in year 14, from trust assets, including the loan proceeds, if not repaid before with death proceeds. 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. In the example below, we assume that the grantor forgives the annual loan interest and a corresponding gift tax applies. Clients should consult their tax advisors.

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 @ 3.85%	Annual Gift to Trust	Loan Repayment from Trust Balance	Net Cash Value End Year	Net Death Benefit End Year	Trust Balance Net of Loan (Includes Death Benefit)
1	48	**4,798,438**	170,700	184,740	184,740	-	52,450	5,046,810	5,246,329
5	52	-	170,700	184,740	184,740	-	604,345	5,272,821	6,443,319
10	57	-	170,700	184,740	184,740	-	1,603,625	5,748,093	8,638,438
14	61	-	-	-	-	4,798,438	2,462,470	6,023,877	10,655,696
15	62	-	-	-	-	-	2,571,349	5,871,590	10,873,954
20	67	-	-	-	-	-	3,205,882	5,234,264	12,584,378
25	72	-	-	-	-	-	4,154,790	6,109,267	16,908,996
30	77	-	-	-	-	-	5,342,906	7,157,083	23,025,428
35	82	-	-	-	-	-	6,801,827	8,402,296	31,718,101
40	87	-	-	-	-	-	8,541,131	9,869,120	44,127,687

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 2023 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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[1] 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.

[2] Distributions under the policy (including cash dividends and partial/full surrenders) are not subject to taxation up to the amount paid into the policy (cost basis). If the policy is a Modified Endowment Contract, policy loans and/or distributions are taxable to the extent of gain and are subject to a 10 percent tax penalty if the policyowner is under age 59½.

Access to cash values through borrowing or partial surrenders will reduce the policy's cash value and death benefit, increase the chance the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.
Life insurance proceeds are generally excluded from the beneficiary's gross income for income tax purposes. There have been a few exceptions such as when a life insurance policy has been transferred for valuable consideration.

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