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Advanced **Markets**

INSURANCE PRODUCTS	
MAY LOSE VALUE	NOT A DEPOSIT
NOT BANK GUARANTEED	NOT FDIC INSURED
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LIFE-8914 12/23

A flexible alternative to outright gifts to purchase life insurance

Life insurance is often purchased to help address liquidity needs and legacy goals as part of a larger estate planning strategy. In order to shield the life insurance death benefit from estate taxes, the policy or policies will often be owned by an irrevocable life insurance trust (ILIT), which typically requires a certain level of gifting to pay for the premiums on the policy.

Under current tax law, individuals can transfer up to $13.61 million (for 2024) free of estate and gift taxes. This amount, which is commonly referred to as your "lifetime exemption," was doubled under tax law changes in 2017, but is scheduled to decrease to $5 million (indexed for inflation) in 2026. That means there is a unique, but limited, window of opportunity to transfer significant wealth outside your estate and help secure the necessary amount of insurance protection to meet your estate's liquidity needs or legacy goals.

For individuals who may be on the fence about making gifts today given the many uncertainties that can surround such a transfer — e.g., what if the estate tax is repealed, what if I need access to that money, etc. — a "wait-and-see" private loan strategy is an alternative to making gifts. This technique puts a plan in place today that helps secure a life insurance policy and gives you the flexibility to make a gift later, should that become desirable.

Lock in interest rates today

With interest rates fluctuating, now is the time to consider private loan arrangements. Locking in today's interest rate allows you to accomplish significant estate planning while limiting the growth within your taxable estate.

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The “wait-and-see” loan technique combines the benefits of a private loan arrangement with the ease of making optional gifts in the future.

How the arrangement works:

1

You enter into a loan agreement with your ILIT, agreeing to make a loan to the trust in exchange for a promissory note. The loan is typically a lump-sum loan, but can also be a series of smaller loans made annually. Interest is charged on the loan balance at or above the minimum rate set by the IRS — known as the Applicable Federal Rate (AFR) — and is usually paid to you annually (but can be deferred and added to the loan principal, if necessary).

2

The ILIT trustee purchases a life insurance policy on your life and uses the borrowed funds to pay the premiums on the life insurance policy as well as the interest due back to you each year.

3

At the end of the loan term, the trustee repays the outstanding loan balance to you using the assets held inside of the trust or via another exit strategy. The ILIT now owns a funded life insurance policy, and the death benefit will be received free of income and estate taxes for the benefit of your heirs. Any appreciation on the trust assets in excess of the loan principal is also removed from your taxable estate.

4

At any point during the loan term, you can decide to forgive all or a portion of the outstanding loan balance. This forgiveness would be treated as a gift and would reduce your lifetime exemption by the forgiven amount. Ideally, you might consider forgiving the note sometime between now and 2026, when the exemption is scheduled to sunset. For example, you may realize that you no longer need to be repaid or perhaps there are future tax law changes that would make gifting advantageous.

If you decide to forgive the note under the wait-and-see plan, not only will you have a funded life insurance policy in the trust, but the forgiven loan principal and all future appreciation will stay in the trust for your beneficiaries and outside your taxable estate.

Example

Under the wait-and-see loan arrangement, you lend your ILIT $5 million for nine years at a 4.82% interest rate (Dec 2023 AFR). For the purposes of this example, assume that the trust can invest those funds and generate a 7% return (or $350,000). From that $350,000 return, the ILIT trustee will pay you interest based on the applicable interest rate (i.e., 4.82% or $241,000) and the remainder could be used to pay the premium on a life insurance policy (i.e., $109,000). At the end of the nine-year loan term, the trustee will repay you the $5 million loan balance. If, however, you decide to forgive the loan during the nine years, the trust will retain the $5 million, plus any appreciation on those funds and the life insurance policy, and you will have made a $5 million gift to your trust.

Key benefits of wait-and-see loans

Locks in your insurability today and puts the plan in place without any up-front gifting

Provides you with greater flexibility to decide when to make a gift (via loan forgiveness) or the option to be repaid under the loan terms

With lump-sum loans, the interest rates can be locked in for the life of the loan

This is a hypothetical example for illustrative purposes only.

Conclusion

A key differentiator in the wait-and-see loan strategy is the flexibility it provides. While there is a limited period of time left to make large gifts due to the increased exemption, there are myriad reasons why gifting right now might not make sense for you. Designing a flexible plan with a “wait-and-see” component gets your plan in place now and gives you ultimate control over the decision to gift, or not, in the future.

Talk to your financial professional about using a wait-and-see loan strategy with life insurance to help with your estate planning goals.

This is the mid-term AFR for Dec 2023. The mid-term interest rate is applicable for loans between 3 and 9 years.

Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds. There can be costs associated with drafting a trust.

This material does not constitute tax, legal, investment or accounting advice and is not intended for use by a taxpayer for the purposes of avoiding any IRS penalty. Comments on taxation are based on tax law current as of the time we produced the material.

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Life insurance death benefit proceeds are generally excludable from the beneficiary’s gross income for income tax purposes. There are a few exceptions such as when a life insurance policy has been transferred for valuable consideration.

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