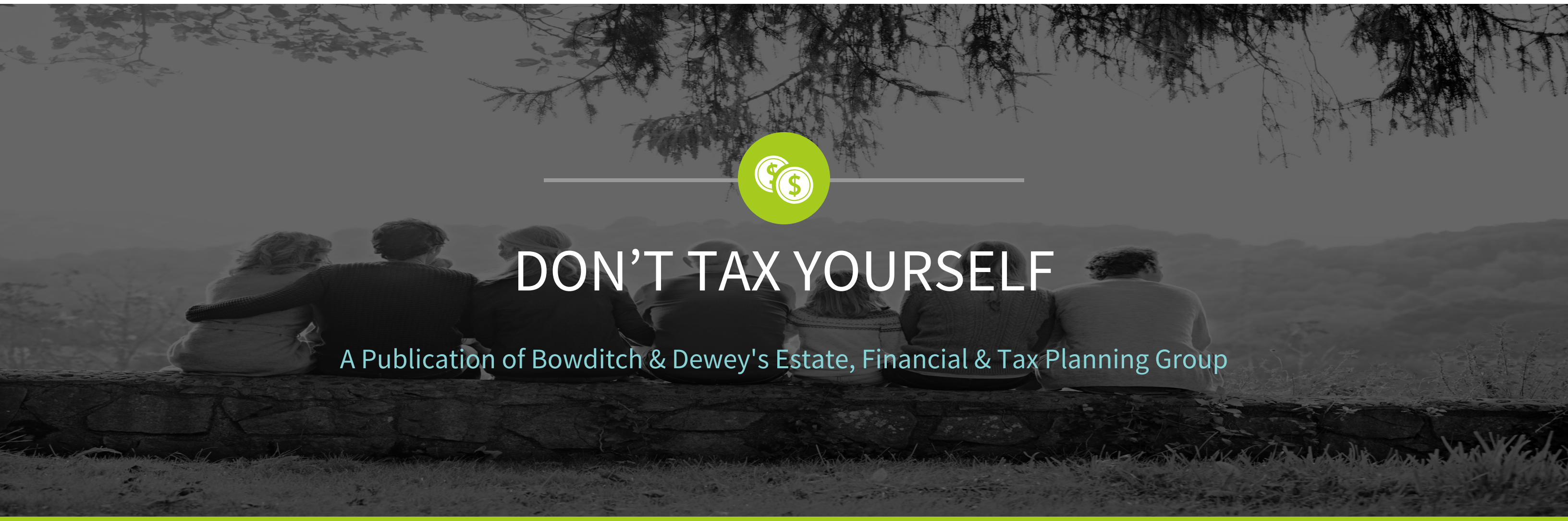

Record Low Interest Rates Let You Have Your Cake and Eat It Too – Life Insurance, Investments & Intra-family Loans

BY REBECCA MACGREGOR • AUGUST 12, 2020

At this time, unless Congress acts, the current lifetime estate tax exemption amount of $11,580,000 is set to sunset in 2025, which means that in 2026 it will revert to $5,000,000 per person, adjusted for inflation. Many clients want to take advantage of gifting the difference between the amounts, $6,580,000 before it is gone. Some families are making outright gifts to children to purchase a vacation home so they can leave the crowded cities or to start up a new business.

However, in this economic environment, not all clients are ready to make an outright gift, but wish they could transfer some of their wealth. Some have already utilized their estate tax exemption amount, but wish they could somehow transfer more wealth without incurring a gift tax. Other families that still have all or a portion of their estate tax exemption amount, but just don’t feel comfortable transferring funds until the economy sorts itself out.

Then this summer, the IRS has released record low Applicable Federal Rates (AFR). For August 2020, the AFR are as follows:

- Short term loans must bear interest of at least 0.17%
- Midterm loans must bear interest of at least 0.41%
- Long term loans must bear interest of at least 1.12%

These low rates are providing an opportunity for families that want to transfer wealth, without making gifts or utilizing their estate tax exemption amount. How are they doing it?

The clients set up an irrevocable life insurance trust to own a life insurance policy on their life. The clients lend the trust sufficient funds to purchase the policy (all premium payments necessary to purchase the policy) plus additional funds for the trust to invest. The trust signs a promissory note to the clients, promising to pay back the loan, with the long term AFR interest rate. The promissory note is an interest only note with a balloon payment of the full principal due at the end of the term. The trust then invests the borrowed funds into a brokerage account.

Each year, the trust pays the annual premiums for the life insurance policy and pays interest on the promissory note to the clients. When the term of the promissory note expires, the trust pays the outstanding principal to the clients. The trust owns a fully funded life insurance policy on the lives of the clients plus any remaining appreciation on the borrowed funds. Upon the death of the clients, the trust funds are held for the benefit of the descendants of the client.

We team up with investment advisors to run projections for the investment rate of return. We also partner with independent insurance advisors to help secure competitive pricing for guaranteed insurance products. These products can be designed to be funded over a defined term of years. Once the cost is known, the required investment needed to pay premiums and interest to outperform the AFR interest rate can be determined.

Please note, we design the trusts as intentionally defective grantor trusts, so the assets are not included in the estate of the clients, but the income is taxable to them each year.