



Advanced Markets *Planning in Action*

Using private finance as a “wait-and-see” gifting approach for life insurance funding

Case in point

The Tax Cuts and Jobs Act of 2017 temporarily increased the lifetime gift and estate tax exemption. The Act provides a window of opportunity to gift large amounts of money through the end of 2025, but many clients may be hesitant to make those gifts and give up control of those assets. In this particular case, one of our Advanced Markets Consultants (AMC) worked with a producer and his affluent client to implement a strategy today that gives the client the flexibility to “wait and see” when, and if, they will make the gift.

Designing a case & creating a plan

Although the client is reluctant to make a large gift today, he has liquid assets that are generating income that he does not rely on for his current living expenses. The AMC worked with the producer to design a solution that creates an Irrevocable Life Insurance Trust (ILIT) with the clients’ daughters as the beneficiaries. The client utilizes private financing to fund a \$15M John Hancock Protection UL policy owned by the ILIT. The design calls for a 9-pay annual premium of approximately \$340K.

How it works

- Client loans his ILIT approximately \$5.7M under a 9-year note arrangement fixed at the current mid-term Applicable Federal Rate (1.53% in March 2020).
- His advisors agree that his loaned assets could be invested with a gross return of 8% annually.
- The ILIT’s income from the loaned assets would be used to make annual loan interest payments back to the client (\$87k) and pay premium on the life insurance policy (approximately \$340K).

Client profile

- Male, age 55, with three daughters from first marriage
- 25M total net worth — \$8M in business interests, \$4M in personal property, \$13M in liquid assets

Fact finding

- Client wants to ensure that each daughter will receive a \$5M inheritance
- Remainder of his estate will go to his current spouse or to charity
- Aware of the new increase in the lifetime exemption to \$11.58M in 2020 and that this increase in exemption is only temporary (set to revert to \$5M, indexed for inflation, in 2026), but uncomfortable making a very large gift today

- Because the ILIT is structured as an intentionally defective grantor trust, the client pays all of the trust's income tax, allowing the trust to grow more quickly because assets do not need to be tapped into to pay taxes.
- Before the increased exemptions, sunset, the client has the option to forgive the loan (i.e., make the gift) or be repaid according to the loan terms.

Why it works

Flexibility and control are the key to this arrangement. The client now has a choice as to when to use his increased exemption — if he even decides to make a gift at all.

1. If client decides to gift

At any point between now and 2025 (sunset year), the client can forgive the indebtedness of his ILIT, thus making a gift. At some point between now and 2025, the client may realize he no longer needs the loaned assets or the income generated by the assets and may be willing to take advantage of the opportunity to use the increased exemption to make a gift. This will increase the amount held in the trust for the benefit of his daughters and freeze the growth on those assets outside of his taxable estate.

For example, if in year 5 the client decides to forgive the loan, the trust would retain the loaned assets (\$5.7M) and hold the life insurance policy on his life (\$15M), making the total trust value over \$20M.

2. If client decides not to gift

This 9-year loan design has a “built-in exit strategy” so that if the client decides he does not want to make a gift at all, the ILIT will repay him the value of the note in year 10. The \$15M life insurance policy will remain in the trust for the benefit of his daughters, and the assets used to repay the loan will be returned to his taxable estate.

Conclusion

While many clients realize the current unique and limited opportunity to do significant wealth transfer planning, they may hesitate to start the process because they fear losing control over their assets should they need access them in the future and/or the tax environment changes. Designing a flexible plan with a “wait-and-see” component, like the private finance design in this case, may be the key to getting these clients to initiate planning today. Want to discuss this case or receive a customized proposal for your client?

Call Advanced Markets at **888-266-7498, option 3** to speak with an Advanced Markets Consultant, or email advancedmarkets@jhancock.com

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MLINY030520022

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