Estate planning with options

Gifts that can be borrowed back

The value of cash value — flexible estate planning

Situation

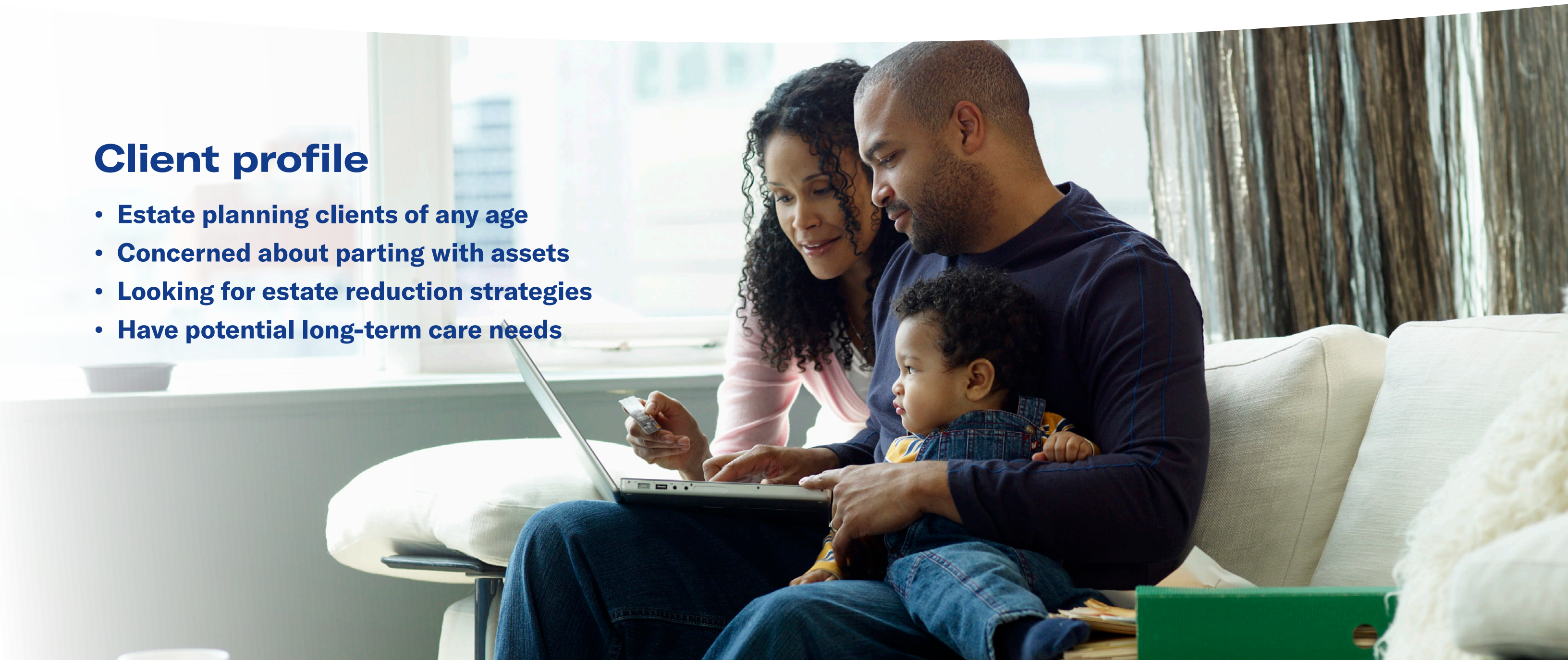
Bill and Karen need to implement their estate plan, but they are concerned about irrevocably gifting away funds to pay premiums. They have a sizeable estate. Although their assets will likely continue to grow, they know they will deplete some assets for their children's college tuition. Their dilemma: The couple wants to keep some funds available, but if they delay funding a life insurance policy until tuition payments are made, the couple will be 10 years older and risk more expensive premiums.

A life insurance strategy

The couple's attorney and financial professional suggest an approach using an irrevocable life insurance trust (ILIT), drafted as a grantor trust for income tax purposes. They suggest the trust could have provisions to allow the trustee to make arm's-length loans of trust assets, including loans to the grantors, Bill and Karen. If they need funds, the trust might act as a bank with the trustee making a loan pegged to an interest rate set by the Tax Code. In this way, the couple can gain indirect access to the trust assets. If the couple sets up the trust to own their life insurance policies, a cash value life insurance policy is central to the plan. And, if the loan is a long-term loan where interest is accrued, they might have the added benefit of further depleting their taxable estate through interest payments owed on the debt to the ILIT.

Strategy summary

- They create a trust and make gifts.
- The trust purchases a permanent life insurance policy with cash value from Equitable.
- If they need funds, the trustee can access trust cash or the policy cash values and make loans to them.
- Interest paid to the trust further depletes their taxable estate, further reducing their tax bill without hurting other gifts they might make.
- Trust assets, including interest paid into the trust, eventually passes to trust beneficiaries, usually their children.



Client profile

- **Estate planning clients of any age**
- **Concerned about parting with assets**
- **Looking for estate reduction strategies**
- **Have potential long-term care needs**

The diagram and chart show how this approach can enhance your planning

You make annual gifts to the trust for premium payments.

Life insurance policy offers a death benefit and builds cash surrender values.

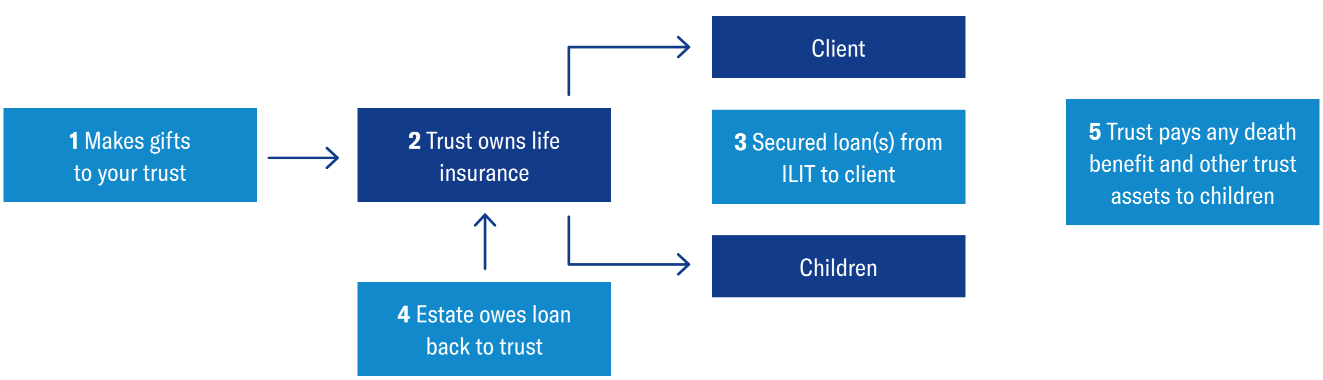
Year	Client age	Premiums paid	Death benefit	Policy cash value	Cumulative premium	Client's assets[1]	Amount borrowed	Loan with interest[2]
1	50	$40,000	$1,500,000	$0	$40,000	$4,000,000		
2	51	$40,000	$1,500,000	$25,000	$80,000	$4,120,000		
5	54	$40,000	$1,500,000	$153,000	$200,000	$4,502,035		
10	59	$40,000	$1,500,000	$422,000	$400,000	$5,219,093		
15	64	$40,000	$1,571,000	$823,000	$600,000	$6,050,359		
17	66		$1,014,000	$285,000	$640,000	$7,068,826	($650,000)	$650,000
20	69		$1,013,000	$336,000	$640,000	$7,724,297		$752,000
25	74		$1,012,000	$429,000	$640,000	$8,954,577		$960,000
30	79		$1,011,000	$532,000	$640,000	$10,380,809		$1,226,000
35	84		$1,009,000	$630,000	$640,000	$12,034,203		$1,564,000

If you need funds, the trustee might elect to make an arm's-length loan.

The loan might accrue interest. This becomes an estate debt, which might further deplete the estate for estate tax calculations, but places dollars into the trust.

The policy premium, cash value and death benefit amounts used for this case are intended only to help demonstrate the planning concept discussed and not to promote the sale of a specific product. The amounts are broadly representative of rates that would apply for a policy of this type and size for insureds of good health in the ages mentioned. To determine how this approach would work for you, individual illustrations should be prepared or requested for your review. If different rates were used, there might be significantly different results.

Loans from a trust



1 Client's assets assumes a generic pool of assets and a 3% after-tax growth rate.

2 Accrued loan interest assumption of 5%.

What products to use?

Our permanent cash value policies offer flexibility and options for clients.

- Adding our Long-Term Care Services℠ Rider offers a trust and trustee additional flexibility if you qualify for long-term care benefits.

What have you achieved?

Your estate planning objectives with an Equitable life insurance policy owned by an ILIT.

- Built cash values in the policy to help maintain flexibility should your cash needs change or to minimize future gifting.
- Retained potential access to policy cash values through loans the trust can make to you.
- A properly constructed loan can further deplete your estate to minimize future estate taxes.
  - You need to weigh whether you should pay or accrue interest. Paying interest every year might help you to remove both assets and your future growth from your estate; however, you might be averse to paying funds out of pocket.
- Any interest paid on the loan to the ILIT will ultimately end up in the hands of the trust beneficiaries, your children.

Taking it one step further

Adding the Long-Term Care Services℠ Rider

If you need life insurance, but also need long-term care (LTC) coverage, one option is adding the Long-Term Care Services℠ Rider (LTCSR) to your policy. For what might be a modest additional cost, one policy might offer both death benefits and LTC benefits. The rider allows you to elect a long-term care benefit of 1%–3% of the death benefit, paid out as a monthly advance.

Using the LTCSR offers the following benefits:

- Because this is an indemnification rider, the trustee doesn't need to incur the long-term care expense; if you fail to meet two out of six activities of daily living, the trustee, as the owner of the policy, can qualify for an advance of the death benefit. This is a substantial advantage over the more common reimbursement rider. The rider does have restrictions and limitations. Be sure to review the details with your financial professional.
- The trustee can use the LTC benefits to:
  - Pay future premiums, thereby reducing premiums you need to gift.
  - Use funds to make additional loans to you to help cover LTC costs.
  - Make distributions to a beneficiary, who might now cover some of your LTC costs.

The LTCSR does have restrictions and limitations. Be sure to review this with your financial professional before making a decision.

Other considerations

- Although the power to compel a loan is established by court cases, careful trust drafting is required.
  - As such, it might be advisable to leave total discretion to the third-party trustee. Another possibility is to give your spouse the right to borrow from a third-party trustee.
  - Recently, the IRS approved an arrangement allowing loans back to the trustee, or exchanges of property, provided it occurred in what is known in tax parlance as an "arms-length" transaction. See IRS Revenue Ruling 2011-28.
- The loan must use the appropriate Applicable Federal Rate (AFR), set by Treasury, and negotiated as if you were borrowing from a bank. Currently, these rates are very low, so this offers clients a unique opportunity.

The trustee has a fiduciary duty to the beneficiaries of the trust and should take into consideration all facts and circumstances prior to making a loan to the grantor.

Why Equitable?

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