MassMutual

A STRATEGY SPOTLIGHT

Using Personal Loans to Fund a Life Insurance Trust

If you are funding life insurance in a trust for estate planning purposes, you should consider the advantages of making personal loans to the trust as an alternative or supplement to making annual exclusion gifts.

Under a loan arrangement, you will not give up control of the funds by making irrevocable gifts to the trust each year, and your annual gift tax exclusion can be used for other purposes.

Consider the Advantages of the Personal Loan Approach:

- The life insurance policy death proceeds, in excess of the loan amount, will not be included in your taxable estate.
- Your annual gift tax exclusion amounts can be used for other purposes, such as making cash gifts to your children.
- You will retain a continuing interest (though indirect) in the trust assets equal to the loan amount.
- At some point, the trustee can use trust assets to repay the outstanding loan. These loan payments are tax free and could be used to supplement your retirement income.
- This arrangement gives you the flexibility to combine gifts and loans that will provide both the estate planning benefits and the desired level of supplemental retirement income.
- In the current low interest rate environment, the cost of borrowing to the trustee is relatively small.

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How the Arrangement Works:

- You establish an irrevocable life insurance trust.
- The trustee applies for a life insurance policy on your life.
- You and the trustee enter into a demand loan agreement.
- You lend all or a portion of annual life insurance policy premiums to the trustee, and you may also make annual exclusion gifts to the trust.
- The trustee assigns the policy to you as security for the loan using a special assignment form that will not cause the life insurance policy proceeds to be included in your estate.
- Loan interest, at the IRS demand loan interest rate, must be paid annually or it will be added to the outstanding loan balance.
- The trustee may access policy cash values via partial surrenders or policy loans to make loan repayments to you.[1] However, there may be little or no cash value available in the early policy years to repay the loan. If the trustee accesses the policy cash values through policy loans, those loans and the accrued interest will reduce the policy death benefit and may cause the policy to lapse before your death. If that happens, it may also result in a tax liability to the trust.
- At your death, the trustee will use a portion of the policy death benefit to repay any outstanding loan balance to your estate.
- The remaining death benefit may continue to be held in trust or distributed to the trust beneficiaries both income and estate tax free.
- At your death, any outstanding loan to the trust will be includable in your taxable and probate estate.

[1] 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% tax penalty.

The decision to purchase life insurance should be based on long-term financial goals and the need for a death benefit. Life insurance is not an appropriate vehicle for short-term savings or short-term investment strategies. While the policy allows for loans, you should know that there may be little to no cash value available for loans in the policy's early years.

The information provided is not written or intended as specific tax or legal advice. MassMutual, its subsidiaries, employees, and representatives are not authorized to give tax or legal advice. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.

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