Allianz Life Insurance Company of North America

LIFE ADVANCED MARKETS

Flexible estate planning strategies

Private Financing

In the United States, we have a right that should not be taken for granted – the right, with only a few limited exceptions, to determine who is to receive the fruits of our labor after we pass away. Taking advantage of this right requires planning strategies, especially when a family's estate includes substantial wealth, business interests, or other complex assets. A well-designed estate plan strategy may also help families minimize taxes that are triggered upon death, protect family wealth from creditors, avoid family strife, and protect beneficiaries from mismanaging their inheritance.



While there are a number of strategies for accomplishing such goals, many require irrevocable decisions be made with limited ability to make modifications should circumstances change (e.g., changes in tax laws, changes in family dynamics, and changes in financial goals/needs). Families and their financial professionals should take into consideration strategies for building a level of flexibility into their plans. One such strategy is a private financing life insurance arrangement.

Life insurance may be a vital part of a family's overall estate plan strategy – providing funds to help pay estate taxes, funds for family members to acquire the family business, or simply providing a flexible asset that is easily allocated among beneficiaries. A common practice is to have the policy owned by an irrevocable life insurance trust (ILIT) in order to avoid estate taxes and control the distribution of death proceeds. Gifts are then made to the ILIT, which uses the funds to pay premiums. One of the primary disadvantages of such a design is that the gifts are irrevocable. Should circumstances change for the insured, they will not have access to policy cash values held within the ILIT. A private financing arrangement is one way to address this issue.

Private financing

Summmary of strategy

Basic design

- Life insurance policy is owned by a third party (typically a family member or ILIT).
- Instead of making gifts, the insured loans money to the owner of the policy to pay premiums.
- The loan is documented by a promissory note.
- Interest is charged at the appropriate applicable federal rate.

Advantages

- Premium payments made are not gifts for gift tax purposes (as long as there is a legitimate intention to repay the loan).
- Promissory note terms are more flexible than commercial loans; the lender may charge a lower interest rate than a commercial lender.
- **The lender retains the flexibility to forgive the loan (turning the loan into a gift) or seek repayment should they need the cash flow at a later time.**

Design considerations

- It may be advantageous to have a portion of the amount contributed to the owner of the policy treated as gifts to reduce the amount of the loan. Each individual may gift $19,000 (2026 annual gift tax exclusion[1]) per beneficiary without being subject to the federal gift tax or using up their applicable exclusion amount.
- The minimum interest rate that may be charged will depend on the term of the loan. There are three different possible rates provided by the IRS – a rate for loans that mature within 3 years, a rate for loans that mature between 3 and 9 years, and a rate for loans with a maturity date over 9 years.
- If annual loans are made each year as premiums come due, the interest rate charged will fluctuate from year to year. An alternative would be to make one single loan and lock in the interest rate. The lump-sum loan may be used to purchase an Allianz Life Accumulator® Indexed Universal Life (IUL) Insurance Policy utilizing the Premium Deposit Fund rider to help avoid creating a modified endowment contract.
- The insured may allow the interest to accrue, or they may pay interest each year. Interest payments would be considered gifts to the policy owner but would avoid having the loan balance grow annually.
- It is very important that the loan be treated as a loan by the IRS and not a gift. When considering the characterization of the transfer of funds, the IRS will look at all the facts and circumstances involved, including whether interest was charged, whether a promissory note was executed, whether any repayment was actually made, and the ability of the borrower to repay the loan.
- It is important to develop a repayment strategy. When and how will the loan be paid off? The loan may be paid off during the life of the insured, all in one lump sum or in installments over a period of years. If policy cash values will be used to repay the loan, the policy should be properly funded and monitored. The loan could also be repaid at the death of the insured. In this case, the loan repayment would be paid to the insured's estate.
- IUL requires qualification through health and financial underwriting.
- Clients should consult with their tax advisor and attorney to discuss their specific situation.



WORK WITH YOUR FINANCIAL PROFESSIONAL to learn how indexed universal life (IUL) insurance can be a part of your estate planning strategies.

[1] Rev. Proc. 2021-45.

The death benefit is generally income-tax-free when passed on to beneficiaries.

Policy loans and withdrawals will reduce the available cash value and death benefit and may cause the policy to lapse, or affect guarantees against lapse. Withdrawals in excess of premiums paid will be subject to ordinary income tax. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. If a policy is a modified endowment contract (MEC), policy loans and withdrawals will be taxable as ordinary income to the extent there are earnings in the policy. If any of these features are exercised prior to age 59½ on a MEC, a 10% federal additional tax may be imposed. Tax laws are subject to change and you should consult a tax professional.

Allianz does not give any legal or tax advice related to the premium financing arrangement. Allianz assumes no responsibility for the obligations, demands, losses, or liabilities, including attorney fees, resulting from the premium financing arrangement.

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