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# The Family Loan Shark

## Using Intra-Family Loans and PPLI to Leverage Wealth Creation and Transfer

We live in uncertain times. Now that is an understatement and a half! Everything is upside down, every where you look around the world. Having said that, the current state of affairs and low interest environment creates an excellent opportunity for high net worth investors to build and transfer wealth strategically. This report creates a path for being able to have your cake and eat it too.

### The Family Loan Shark Planning Technique

The Family Loan Shark technique that allows a taxpayer to make an intra- family loan to an irrevocable trust (Family Trust).  The trustee of the Family Trust is the applicant, owner, and beneficiary of a private placement life insurance (PPLI) policy. PPLI is an institutionally priced variable universal life insurance policy with customized investment options. The trustee uses the loan proceeds to fund the PPLI policy on a non-MEC basis. Non-MEC funding allows the trustee to request tax-free policy loans and withdrawals. Without the benefit of PPLI, the trust would either be taxed to the taxpayer at his high personal marginal tax rate or at the top trust bracket which is reached with only $12,900 of trust income.

The trust design allows the trustee to make tax-free distributions to the taxpayer as beneficiary. The trust design ensures that the policy is beyond the reach of the taxpayer's personal and business creditors. The PPLI death benefit is income and estate tax-free. The trust design may allow the trust to be generation skipping for multiple generations.

The loan is structured at the long term applicable federal rate which is 1.01 percent per year. The loan is unsecured and allows the taxpayer to either pay or accrue interest until the end of the loan term, the taxpayer's life expectancy. All of the growth of the loan proceeds accrues within the PPLI policy income and estate tax-free. The promissory note at such a low rate is essentially frozen over decades.

### Intra-Family Loans

The typical intra-family loan is a cash loan between family members. Usually the loan is between the senior generation as lender to a junior generation as the borrower. The loan arrangement is captured in a promissory note with or without security for the loan. In this case, the loan is between the taxpayer and the trustee of the family trust.

In order to avoid the tax rules for below market interest rate loans under IRC Sec 7872, the minimum interest rate for the loan must be equal to or greater than the applicable federal rate based upon the length of the loan. The current AFR for short term; mid-term and long-term loans for June 2020 is as follows:

| TERM | TIME PERIOD | RATE |
|---|---|---|
| Short Term | 3 years or less | .18% |
| Mid-Term | Less than 9 yrs (greater than 3) | .47% |
| Long-Term | More than 9 yrs | 1.01% |

**Strategy Example #1**

John Smith, age 60, is a high net worth investor. His wife is also age 60. His portfolio has generated an 8 percent annual return over the last ten years. He has $10 million invested in hedge fund strategies and would like to maximize the tax advantage of his investments for both income and estate tax purposes. He is in a combined marginal tax bracket of 47.8 percent (37 Fed+3.8% Medicare +7% state). John and his wife utilized both of their estate tax exemptions in 2020.

**Strategy**

John makes a loan to his Family Trust. The terms of the loan provide for a loan of $5 million at the long term AFR for June – 1.01%. The loan is a 30-year loan that provides for the capitalization of interest and principal, i.e. any accumulated interest and principal will be paid at the end of the loan term. The loan will be an unsecured loan.

The trustee of the Family Trust purchases a PPLI contract insuring John's life. The policy is funded on a non-MEC basic with a premium of $1.25 million per year. The initial death benefit is $25 million.

| Year | PPLI CV | Accumulated Loan |
|---|---|---|
| 10 | $10.8 million | $5,050,500 |
| 20 | $23.3 million | $6,010,000 |
| 30 | $50 million | $6,515,000 |

**Summary**

The Family Loan Shark technique combines the best of several sophisticated strategies coupled together. The intra family loan transfers wealth into a family trust that is designed to provide asset protection. The trust design allows the taxpayer to remain as a discretionary beneficiary with respect to income and principal. PPLI provides for tax-advantaged growth and tax-free distributions as well as an income and estate-tax free death benefit. The technique allows the taxpayer to freeze growth in his own taxable estate. The low interest rate environment provides a unique opportunity for high net worth investors to turbocharge their wealth accumulation and transfer possibilities.

For more information, schedule an appointment with Gerry Nowotny to see how the Family Loan Shark can work in your situation.