

Financing strategies for life insurance owned by an irrevocable life insurance trust (ILIT)



	Annual exclusion gifts	Lifetime gift tax personal exemption	Private split dollar (Economic benefit regime)	Private split dollar (Loan regime)	Interest-only installment sale to ILIT	Premium financing
<p>Basic description</p> <p><i>(all trust agreements used for these ILITs are assumed to be drafted and operated as grantor trusts for income tax purposes, meaning that all trust income is taxed to the trust Grantor)</i></p>	<p>Cash gifts from Grantor to ILIT within the limits of available annual gift tax exclusions are used by Trustee to pay premiums; the use of Crummey provisions to help qualify contributions as annual exclusion gifts is a best practice: \$17,000 per gift donee per year for 2023</p>	<p>Cash or income-producing property within the available limits of the lifetime gift tax exemption is gifted by Grantor to the ILIT; cash, or income from the gifted property is used to make premium payments. \$12,920,000 in 2023 per donor (indexed for inflation but may be subject to a reduction of approximately 50% beginning in 2026¹)</p>	<p>Grantor/insured pays premiums under an economic benefit, restrictive collateral assignment split dollar agreement, potentially using a limited-pay design; Trust owes Fair Market Value (FMV) of policy to Grantor. Grantor can use some or all of gift tax lifetime exemption and/or make ILIT the remainder beneficiary of a grantor retained annuity trust (GRAT) or charitable lead trust (CLT) or convert to a loan. Grantor treated as making annual gifts of the economic benefit cost to the trust beneficiaries.</p>	<p>Grantor loans premiums to ILIT using restrictive collateral assignment of the life policy; with proper planning, Grantor uses annual exclusion gifts to cover interest payments; interest rate is based on blended annual rate for demand loans or applicable federal rate for term loans; loan might be repaid through policy cash values, policy death benefit, or debt forgiveness that would be considered a gift from the Grantor to trust beneficiaries. GRAT or CLT remainder interest may also be a source of repayment funds.</p>	<p>Property, typically stock in a closely held family business, is transferred to an ILIT in return for an interest-only installment note, with principal payable in full at the end of the note's term or at the grantor's death; typically, a 10% down payment is part of the arrangement (funded by a gift from the Grantor to the trust); income generated by the asset is used to pay interest and insurance premiums.</p>	<p>Third-party lender loans premiums to ILIT; policy values and personal assets of Grantor may be needed for collateral; Grantor uses annual exclusion gifts for interest costs; interest rates depend on loan terms and may change as often as each month or year; loan might be repaid through policy cash values, policy death benefit, or outside assets generally gifted into the ILIT by the Grantor.</p>
<p>When to use</p>	<p>When the amount of available gift tax annual exclusions are greater than the annual premium</p>	<p>When available annual exclusions are less than the annual premium; income producing property is available for gifting; desire or need for</p>	<p>To finance large purchases of life insurance where annual exclusions are less than the annual premium (the use of Crummey provisions to help</p>	<p>To finance very large purchases of life insurance where annual exclusions are less than the annual premium (the use of Crummey provisions to help</p>	<p>To finance very large purchases of life insurance with no gift tax annual exclusion usage; where Grantor's lifetime gift tax personal exemption is available</p>	<p>When a large death benefit is needed and the insured's assets are illiquid, or are earning a return that exceeds the costs of borrowing under the premium</p>

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When to use <i>(continued)</i>		one-time funding is present; Grantor is interested in removing highly appreciated property from estate; larger estates; desire to minimize risk that future gifts might not be completed	qualify contributions as annual exclusion gifts is a best practice); and where rollout values are less than \$12,920,000 in 2023 (indexed for inflation but may be subject to a reduction of approximately 50% beginning in 2026 ¹) if insured hasn't already used up lifetime gift tax exemption.	qualify contributions as annual exclusion gifts is a best practice); and where rollout values are less than \$12,920,000 in 2023 (indexed for inflation but may be subject to a reduction of approximately 50% beginning in 2026 ¹) if insured hasn't already used up lifetime gift tax exemption.	to a significant degree; where income (cash flow) from business interest is available	financing arrangement; the insured needs insurance now, and anticipates a foreseeable cash influx, such as an inheritance or sale of a business; when interest rates are low; most suitable for estates valued at \$10,000,000 or more
Primary leverage point	Simplicity: very easy to understand and implement; annual gift tax exclusion is lost if not used during a particular year. (The use of Crummey provisions to help qualify contributions as annual exclusion gifts is a best practice.)	Fairly straightforward; Discounting, particularly of income-producing assets, can maximize values for gift tax purposes; removal of future appreciation reduces estate; works well with short-pay scenarios	Amount of gift is measured by the value of the economic benefit provided by the death benefit to the ILIT, rather than by interest rates; however, economic benefit costs increase as the insured ages.	Amount of gift is measured by interest due and payable, unaffected by the age of the insured; however, interest rates may increase, depending on market conditions.	Insurance premiums on a very large policy are payable without concerns regarding the sufficiency of available annual gift tax exclusions; also a financing mechanism is established to pay future premiums when the policy is purchased; gift tax annual exclusions are preserved for other purposes; many income tax advantages (described below)	Grantor's out-of-pocket expense may be limited to interest cost; grantor's annual gifts are measured by interest costs during the term of the loan; allows grantor to deploy current resources for investments or other needs and delay need for larger gifts to repay loan until a later time.
Duration	May cover lifetime level-pay or limited pay durations	Gift(s) may occur at one time or at multiple times; future growth in lifetime exemption may also be utilized (lifetime gift tax exemption is	Typically best to limit duration (and premium payment period) to minimize increases in economic benefit; staying in arrangement for a long time can be	Typically best to limit duration (and premium payment period) to minimize interest costs; repayment may come from lifetime exclusion gift, remainder interest	One initial transaction is all that is needed to implement this financing approach; once established, the goal is for the arrangement to be self-sustaining	Durations may vary according to client needs and terms of the loan; typically, loan is repaid no later than at death, but may need to be repaid earlier with

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Duration <i>(continued)</i>		scheduled to be reduced in 2026)	too costly and, if GRAT used, increases the risk of GRAT underperforming	proceeds of GRAT or CLT, or policy cash value.		lifetime exclusion gift, or remainder interest proceeds of GRAT or CLT, or policy cash value
Ability to escape	Cash gifts can be discontinued at any time; if limited-pay, annual exclusions are available for redirection for other gifting needs when payment period ends	Once gift to ILIT is completed, it cannot be undone	Arrangement can be terminated by the ILIT transferring the policy to the Grantor without an income or gift tax consequence. If GRAT used, it will continue to operate and pay remainder interest to ILIT when it terminates	If loan amount is not repaid (through policy cash value or otherwise), the loan forgiveness amount would be considered a gift from the Grantor to the trust	Generally, no opportunity to escape or undo arrangement; if an escape option were included, it would probably require a large gift by the Grantor to the ILIT so the note can be completed	Lender will need to be repaid so a large gift by the Grantor may be necessary to the extent policy values in the ILIT are not sufficient to repay; outside collateral is at risk to the extent policy cash value is less than the outstanding loan balance
Considerations	First choice of many Clients, and legal and financial professionals, due to simplicity and ease of termination	Clients need to be comfortable with the idea that gifted property cannot be recovered; income from asset may vary and may not be adequate at some point	A rollout strategy must be planned from the outset; may not be appropriate for older ages due to increased risk of early death; short pay limits risk of increasing economic benefit cost due to insured's aging. If GRAT used, and GRAT investment performance is below projected, remainder interest may not be big enough to pay off split dollar arrangement; fair market value of GRAT assets will be included in estate if death occurs before GRAT is terminated ²	A rollout strategy must be planned from the outset to minimize risk of rising interest rates. If GRAT used and GRAT investment performance is below projected, remainder interest may not be big enough to pay off split dollar arrangement; fair market value of GRAT assets will be included in estate if death occurs before GRAT is terminated. ²	Loss of direct control over asset by seller; no step-up in cost basis for trust beneficiaries at seller's death on business assets in the ILIT; income from asset may vary and may not be adequate at some point; the pre-transfer value of the asset is essentially still in the estate in the form of proceeds from the installment note	Degree of uncertainty due to changing interest rates and sufficiency of collateral issues; cost of insurance is higher due to more death benefit being purchased; significant personal assets may be tied up as collateral for the loan; once initial financing ends, new financing on uncertain terms may need to be obtained or a new financing strategy developed

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Gift tax impact	Consumes some or all of available gift tax annual exclusions	Annual exclusions remain uncommitted in future years and are available for other purposes; lifetime gift tax exemption is depleted to the extend used.	Gift tax annual exclusions are leveraged: lifetime gift tax personal exemption is used at termination, resulting in no out-of-pocket gift tax cost. If GRAT used, remainder interest moves from GRAT to ILIT without gift tax impact	Gift tax annual exclusions are leveraged: lifetime gift tax exemption is used at termination, resulting in no out-of-pocket gift tax cost. If GRAT used, remainder interest moves from GRAT to ILIT without gift tax impact	Gift tax annual exclusions are not used; a large on-time gift for the 10% down payment is required at the outset which may or may not fit within the Grantor's lifetime personal exemption; a large gift may be needed to undo the plan	May consume some or all of gift tax annual exclusions; a large, unexpected gift may be necessary (difficult if assets are illiquid)
Estate tax impact <i>(for all strategies, some or all of death proceeds are out of the insured's estate)</i>	Annual exclusion gifts reduce the Grantor's estate	Future appreciation is removed from estate tax calculation	If insured dies while arrangement is in effect, value of policy (i.e. amount owed back to the grantor) will be included in the estate. If insured dies while GRAT is in effect, value of future GRAT annuity payments will be included in estate ² .	If insured dies while arrangement is in effect, value of policy (i.e., amount owed back to grantor) is included in the estate. If insured dies while GRAT in effect, value of future GRAT annuity payments will be included in estate. ²	Monetary value of assets sold is still in estate, but appreciation of assets after sale to the ILIT is removed from estate	Annual exclusion gifts used for interest costs reduce estate
Income tax impact	None (it's assumed that cash gifts are used to pay premiums so they would not generate any taxable earnings)	Since ILIT is a grantor trust for income tax purposes, income from property in the ILIT is taxed to Grantor (same result as if Grantor did not transfer property)	No income tax impact from ILIT payments to Grantor for economic benefit costs because ILIT is a grantor trust for income tax purposes; cash value growth is tax-deferred. If GRAT used, income generated by property inside GRAT is taxed to the Grantor (same result as if Grantor owned property outright)	None (it's assumed that the ILIT is a grantor trust and that interest owed to the grantor is offset using annual gift exclusions, or part of the lifetime exemption)	Income generated by property inside ILIT is taxed to the Grantor (same result as if Grantor owned property outright); no tax recognition of capital gain or interest by Grantor on installment payments since the ILIT is a grantor trust for income tax purposes; income tax payments by Grantor on income earned by trust assets are, in effect, gift tax-free transfers to the trust	Interest costs aren't deductible by either the Grantor/insured or the ILIT

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Rollout	No rollout strategy is needed	No rollout strategy is needed	Terminate by the Grantor forgiving what is owed to the Grantor by the ILIT (value of the collateral assignment), which creates a taxable gift to the ILIT of the same amount (typically using the lifetime gift tax personal exemption); exemption is currently \$12,920,000 per donor in 2023 (indexed for inflation but may be subject to a reduction of approximately 50% beginning in 2026 ¹). If GRAT used, GRAT has the same duration as the limited pay period on the policy; when the GRAT terminates, the remainder interest is paid to the ILIT; the ILIT uses this amount to repay the grantor	Terminate by the Grantor forgiving what is owed to the Grantor by the ILIT (the amount of the loan), which creates a taxable gift to the ILIT of the same amount (typically covered by the lifetime gift tax personal exemption); the exemption is currently \$12,920,000 per donor in 2023 (indexed for inflation but may be subject to a reduction of approximately 50% beginning in 2026 ¹)	No rollout strategy is needed; the sale may be completed at the seller's death; alternatively, under the right economic circumstances, the note may be repaid using trust assets prior to death	Lifetime rollout, which keeps the policy in force without current or future contributions from Grantor, is not always possible. Rollout could be completed with a lifetime exemption gift or coordinated with a GRAT or CLT to pay off lender at a predetermined time

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¹ Lifetime gift tax personal exemption is scheduled to sunset after 2025 and revert to its 2017 numbers, adjusted for inflation. IRS has not yet issued exact amount.

² If a GRAT terminates prior to 2026, there may be less of a concern about estate inclusion because of the larger lifetime gift and estate tax exemption prior to sunset.



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