What's the Answer? Split Dollar Loan from Descendants' Trust to ILIT. The trustees of the Descendants' Trust, as directed by the trust's investment advisor, agree to enter into a SDA with the ILIT, under which the Descendants' Trust will make annual loans to the ILIT equal to the annual life insurance premiums ($65,000). Each loan's term will be based on Alex's then life expectancy (as determined under applicable IRS actuarial tables), and each loan will accrue interest annually at the applicable AFR based on the month the loan was made and the loan term. For the exit strategy, the ILIT plans to repay the SDA loans and accrued interest at Alex's passing using the death benefit proceeds from the life insurance coverage.

Bottom Line: Turbo-Charged SDA Fits the Bill. With this approach:

- Alex has leveraged the liquidity in his existing plan to provide for needed life insurance coverage while also preserving his personal liquidity.
- As both the Descendants' Trust and the ILIT are grantor trusts with regard to Alex for federal income tax purposes, the loans are disregarded and should not generate federal income tax.[6]
- Assuming that the split dollar loans between the trusts charge adequate interest and are fully repaid, there should be no gift or GST tax concerns for Alex, the trusts, or the beneficiaries.
- Alex does not need to use any of his limited gift or GST tax exemptions to support the plan.
- The full $12 million death benefit and the SDA receivable remain outside of Alex's estate.

Practical Notes.

- While the Descendants' Trust initially provides annual loans, the trusts could later re-negotiate the SDA so that the Descendants' Trust provides a lump-sum loan to the ILIT to pay premiums to lock in the loan interest rate and help limit the ILIT's exposure to future interest rate hikes.
- Where the beneficiaries of the existing trust and the ILIT differ, the trust-to-trust SDA should be monitored to review the total SDA receivable (loans plus accrued interest) to ensure that sufficient death benefit remains in the ILIT for its specified beneficiaries. Otherwise, additional exit strategy planning may be considered, such as gifts to the ILIT to create a "side-fund" for repayment.