An IBC Tax Strategy
PART III

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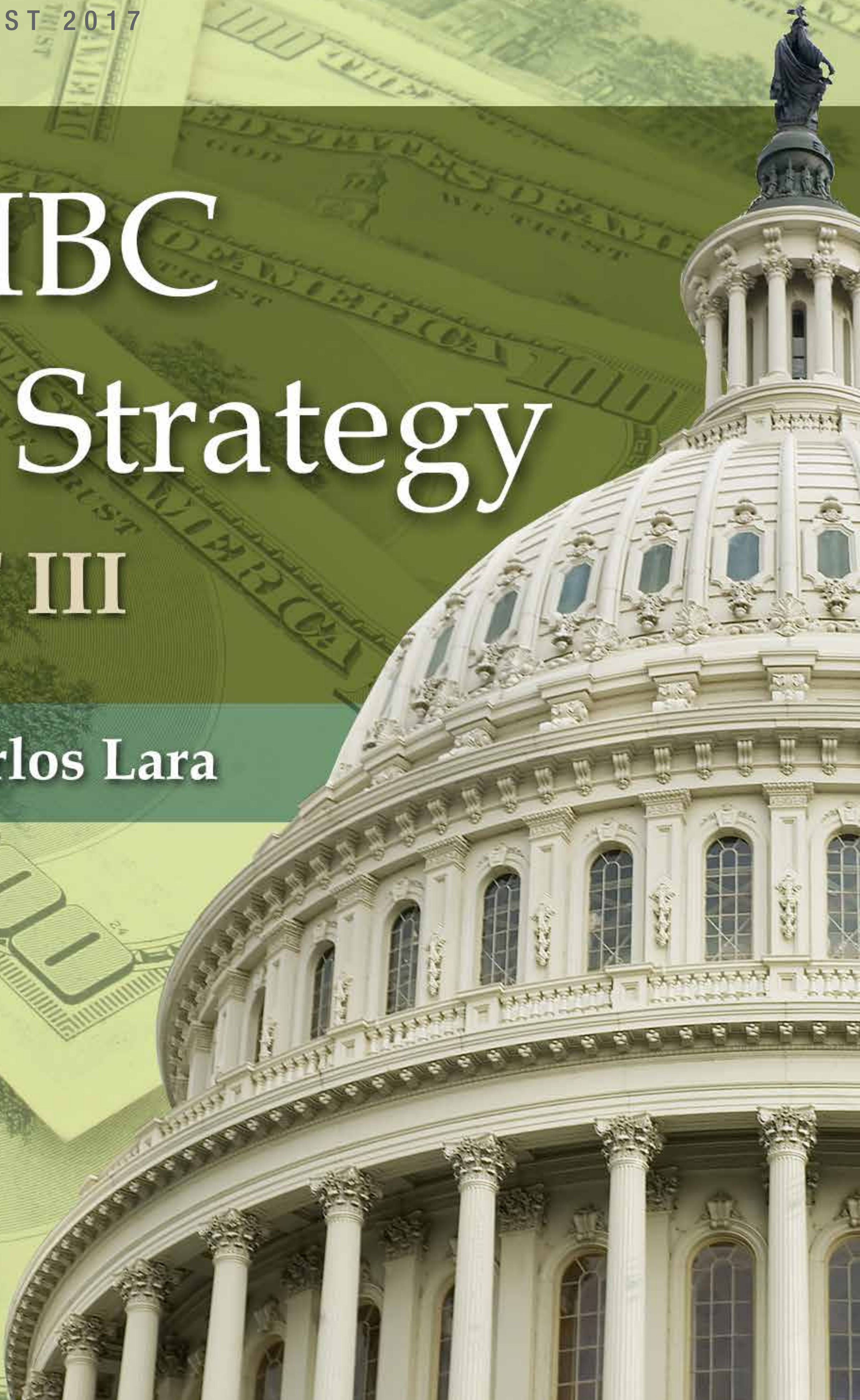

In this third and concluding article about an IBC Tax Strategy, a strategy that I personally use, I would like to shift gears and steer our thoughts in the direction of some very important rules that govern life insurance policy loans. As individuals that practice IBC these discretionary guidelines with regards to policy loans should be fully understood, whether we are members of the general public, or financial professionals. This is the main reason that I reiterated several times in the preceding two articles that this particular tax strategy was not for novices, or those new to IBC.

To clarify, let me put it to you this way. We must never forget that beyond all of the outstanding attributes of a properly designed dividend-paying Whole Life insurance contract and how it works, policy loans are a completely separate undertaking and are a central feature of the *Infinite Banking Concept*. In other words, IBC is never really being fully practiced without policy loans being utilized at some point in the process. Consequently, knowing all the ins and outs of how policy loans work is crucial to getting the most out of practicing IBC. The good news is that there are only a few critically important best practice guidelines that we must know and understand. These few principles are the subject matter of this final article of this three-part series.

If you are new to IBC I encourage you to continue to broaden your education about IBC using our podcast and our website, especially with regards to policy loans. Robert and I have written quite a number of articles specifically about this subject ever since 2010 when we first launched the *Lara-Murphy Report (LMR)* and they are all available in the ***LMR*** archives for subscribers. But whether you are an ***LMR*** subscriber or not,

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I would at least like to recommend that you read "The Policy Loan Debate Explained," which I wrote in the September 2014 issue of the ***LMR*** as a starter article. You can find a *free* copy of it here: https://lara-murphy.com/lmr-greatest-hits/ Many other free articles on policy loans are also located on this same page and I recommend that you read as many of them as you can before you begin to use IBC in your own economic affairs.

The Ideal Strategy for Business Owners

Before launching into the most critical rules on policy loans, let's briefly review the main reason that I wrote this series in the first place and why I believe this is the ideal tax strategy for a business owner primarily.

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It all started with an attempt to answer a typical objection that I would often hear being expressed by business people once it dawned on them that practicing IBC would in fact allow them to eventually wean themselves from their dependency on commercial banks and in particular from the clutches of a commercial bank's overt collateral requirements. As a prerequisite the collateral that commercial banks demand include the assets of the business and the personal guarantee of the business owner. This is why once the workings of IBC and policy loans are fully understood, the business owner has no difficulty choosing the superior stress-free option.

Still, the limiting factor for many business owners to be able to obtain an IBC-type policy was that all of their excess cash flow was tied up elsewhere. They had enough business savvy to know that in order to obtain an IBC banking policy large enough to accommodate the required needs of their business a significant amount of ready capital would be required to fund such a policy. So I simply suggested that the business owner could take cash flows that were already earmarked for paying taxes to the IRS and re-route them through a correctly designed IBC policy that would have the capacity to adjust to the business owner's particular situation.

By using this particular strategy the business owner would in effect be making use of the same money that was already set aside to pay the government and wind up accomplishing two things with it instead of just one. All he had to do was to first direct these monies to set up his IBC policy then turn around and pay them to the IRS using a policy loan. He would do this again the following year and continue this same procedure for several years until he had built up a sizable IBC infrastructure with a huge death benefit. My illustrations (in Part 2 of this article) showed ten consecutive years of policy loans as an example, although one of them was a real life case study. Building the large death benefit was the initial goal of this strategy and then later, at some time in the future, the business owner would repay these loans with *"windfalls"* or the sale of business assets.

I want to stress again that there is nothing magic going on here; we are not conjuring up wealth out of thin air. This is why I included actual illustrations provided by a life insurance company to show exactly what I meant. Furthermore, when I talk about the IBC "tax strategy" *I am not talking about reducing your tax liability.* You are still payng your normal tax bill to the IRS. I am simply showing the business owner how to use the same cashflow to build up an IBC infrastructure in addition to satisfying the tax man.

I focus on the business person because he has large cashflows. This is not to say that an employee on a fixed income does not ever have a windfall or that such an individual never sells an asset and then needs a place to store the proceeds from that sale. I simply mean that this idea resonates most strongly with business owners because they can *create* windfalls by generating additional business profits and, as a rule, they strive to build up business assets in order to sell them later for a profit.

What really makes this IBC tax strategy work as efficiently as it does boils down to the way the life insurance contract is initially designed, combined with the following three important attributes of a dividend-paying Whole Life insurance policy. We have already discussed all three of these in detail in the previous articles, but it is well worth listing them once more for emphasis.

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1. Access and Control Over Your Money: If you have cash value in your policy you have a contractual right to *policy loans.*

2. Flexibility of Repayment Terms: Although an outstanding policy loan rolls over at interest, you can pay it back on your own schedule, or even not at all, if you wish.

3. Uninterrupted Compounding Of Your Money: Whatever amount you borrow—that same amount continues to earn money in the form of interest, dividends, and equity in your policy as long as you live and as long as your policy remains in force.

The Important Discretionary Guidelines of Policy Loans

Notice that I refer to the policy loan rules as *"discretionary guidelines."* This is because in the final analysis these rules are up to you, the policy owner, to exercise or not. For example, with regards to point number 2 above—in reference to the flexibility of the repayment terms of policy loans, I clearly state that you can pay back the policy loan *"on your own schedule, or even not at all, if you wish."*

That statement is not a misprint. It is absolutely true of policy loans. But in the context of my discussion of an IBC tax strategy, it would be contrary to the true practice of IBC if you did not pay back your loans at all. This important point has been repeatedly stressed throughout this series and I am restating here again. In other words, it is absolutely in the best interest of the policy owner who is practicing IBC to repay his policy loans.

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The reason for this insistence is that we must not forget our primary purpose for practicing IBC in the first place. IBC is first and foremost a cash flow and financing system that allows you to borrow from the insurance company using your cash values in your policy as the collateral. Repayment of policy loans is what releases the collateral and replenishes your line of credit with the insurance company so that you can re-use the cash values again for either emergency expenditures, investments and/or for purchasing big-ticket business assets.

The true IBC practitioner realizes and accepts that this *process* of using the Whole Life policy as its *platform* is the *"alternate"* cash flow and financing mechanism he has been looking for to replace the commercial banking system, which he was previously using with all the duress that came with it. This alternate system now becomes his main (so called) *privatized* bank and the primary place where the bulk of his "dollars" should ultimately reside. So naturally there is a very strong economic incentive to pay off policy loans with windfalls and proceeds from the sale of business assets.

In effect, the entire IBC process involves *"overfunding"* the policy without *"MEC-ing"* it in the initial capitalization phase and then *"re-funding"* it again when policy loans are paid off, thereby replenishing the business owner's capital base. Practicing both phases of this process is representative of sound money management and the best use of *time* as an ally.

Years later, once the business owner is ready to retire with his substantial cash values and the huge death benefit in his policy, he can now re-direct the dividends, which by now will also be huge, into a tax-free income stream to sustain him in old age. Then at his death it all culminates with the beneficiary, or beneficiaries, or his estate receiving that large death benefit income tax free. All this to say that by practicing IBC correctly and responsibly there will never be the worry of a 1099 surprise or the worry of the IBC policy ever being underwater.

Avoid Surrendering The Policy… Until Death

There is one complication. This error can potentially trigger a taxable event especially if you have had the policy for a number of years, have surpassed the cost basis of the policy (the premiums paid in) and have been taking out tax free dividends and withdrawals and still have sizable unpaid loans too close to the cash values on the books. I do, however, want to underscore the word *potential* because the way to keep that potential taxable event from ever occurring is to never *surrender* the policy. Quite frankly, there is absolutely no need to do such a thing unless the entire U.S. economic system derails. Short of this type of catastrophe there is no need to surrender it when practicing this strategy. The surrender is what makes the potentiality of the tax event more certain.

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Specifically, what can happen is this: If you surrender a life insurance policy, then at that point the IRS will look at its history. If, during the life of the policy, you have "taken more out of it" (in the sense of dividends, withdrawals and policy loans) than you "put into it" (in the form of premium payments and loan repayments), then the IRS is going to treat the *net* wealth you extracted from the policy as taxable income.

Because of this possibility, you want to make sure you handle your IBC policy such that you never find yourself in a position where you want to surrender it. The policy must be allowed to continue to chug along utilizing

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its uninterrupted compounding mechanism on its credited interest rate and its dividend payments to build up equity in the policy as described in point number 3 above. In spite of sizable policy loans outstanding, the policy's earnings will stay ahead of them. Recall that due to the design and structure of the policy, you, the policy owner can never be obligated for a loan that's greater than the available cash value. The policy will stay ahead of your loans as long as you live and ***as long as your policy stays in force.***

To further reinforce the value of practicing IBC in general and this strategy in particular is the IRS's ruling under Title 26 Section 7702 (a) thru (g)[1] and again in Title 26 Section 101(a)[2], which together state that any and all cash value growth in the policy is not taxable in any year and any distributions taken out of the policy including its gains are not taxable in any year, plus if the policy is held until death the taxation of any gains are avoided altogether. On top of that, the beneficiary of the death benefit receives it income tax free.

To repeat, the type of error I'm warning about is made when a policy owner mistakenly surrenders a policy to pay for an outstanding policy loan. That transaction can potentially create a taxable event, not because the loan is taxable, but because the surrender of the policy itself *may* be taxable. This is because the policy surrender while you are still alive causes the entire principal and all the gains to become revealed as though they were withdrawn all at once at the time of the surrender, thus triggering the tax.

This action by the policy owner signals the insurance company to pay itself out from the

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remaining cash values (not the death benefit) leaving the policy owner to pay the tax on all the gains with the remaining money, which may or not be there if you stripped all of your capital base by never paying off any policy loans. Of course, if you surrender the policy at a time when you know you have not surpassed the cost basis there will be no tax due. Additionally, if you surrender the policy with a hefty capital base enough to pay off the policy loans and still have enough cash value left over to pay the tax then it's pretty much a wash.

The other common mistake is made when a policy owner believes he can no longer make the premium payments on the policy to keep it in force, therefore allowing the policy to lapse. If you are having problems making the premium payments all you have to do is ***restructure*** the policy so that some of the policy's working parts, such as PUAs, death benefit, or dividends are partially surrendered or directed in such a way to make sure the premium payments are continuously made and this will keep the policy in force until your death, which is the main goal of this strategy.

Everyone who practices IBC must know about the potential tax problems caused by policy surrenders and the available *premium payment restructures* available in all dividend-paying Whole Life insurance polices obtained from a mutual or a mutual holding company. This knowledge is a must. But as I've stressed, so long as you are playing "honest banker with yourself" and paying down your outstanding policy loans according to a schedule, then you will never get into dangerous waters.

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Annual Policy Reviews and In-Force Illustrations

There is one final piece of advice. Practicing IBC and especially the IBC Tax Strategy that we have been discussing here requires monitoring of your policy or policies. Remember, this is a cash flow and financing system you are managing. Consequently, you should do a review of your policy with the help of your *Authorized IBC Practitioner* each year. Your insurance company will provide you an annual snapshot of your policy each year at the end of your policy's anniversary date. This is an excellent time to do your policy review. Ask questions and become familiar with all of the terminology in the policy's annual statement and especially how to read the policy's progress.

Since you, the policy owner, are ultimately in charge of taking out and paying off policy loans with windfalls and proceeds from the sale of business assets, learn how to request an *"in-force illustration"* from the insurance company. These in-force illustrations can project for you several years into the future to see how the policy is expected to perform from the day of your request.

These projections take into account current crediting interest rates, current loan rates, and premium payments to help guide the cost and consequences of future loans and pay offs. I know that we are currently in a prolonged low interest rate environment, but the reality is that we live in a volatile interest rate world where the values of assets can change overnight. These projections will help you see down the corridor of the future to help guide you in making important business decisions to steer away from potential future problems.

For example, these in-force projections may show you that say five years down the road you may need to make adjustments, like pay the interest each year for a few years to slow up the compounding interest on loans if you don't have enough to reduce the principal at the present time. Or, you may need to restructure the policy much earlier than you first thought. The point is that the entire IBC process is flexible and you have options when you are monitoring your IBC policy sensibly.

Learn how to request an "in-force illustration" from the insurance company.

Once you know and understand these few important discretionary guidelines to the successful practice of IBC, including policy loans, you can do the IBC type tax strategy with *any* recurring expense you may have, not just your taxes. If you will always practice IBC correctly and responsibly, as these three articles have made clear, you can do this strategy with complete confidence.

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