ESTATE PLANNING FOR LIFE INSURANCE:
IRREVOCABLE LIFE INSURANCE TRUST

My clients purchase life insurance to accomplish several major objectives. A main objective is to create an estate legacy that will provide enough liquidity for their families to sustain an accustomed standard of living after a death. Some clients have a need to fund the payment of expected estate taxes and prefer to purchase life insurance to fund the estate tax payments rather than using their accumulated wealth which they would rather bequeath to their families or charity. Other reasons my clients purchase life insurance may be to equalize potential unequal distributions to family members or to fund the purchase of closely held business stock that may be mandated by buy sell agreements.

An irrevocable life insurance trust (which is often referred to as an ILIT) can be created by the owner of a life insurance policy so that the policy can be transferred to the trust. The creator of the trust, known as the Settlor or the Grantor, can transfer the policy to the trust to be managed and maintained by the Trustee of the trust. The Trustee usually is someone other than the Settlor or Grantor. Upon the death of the Settlor or Grantor, the Trustee is directed to obtain the death proceeds and to continue to manage and distribute the death proceeds pursuant to the terms of the trust agreement. Therefore, continued management of the proceeds for the family is achieved by the Settlor or Grantor after their death. These trusts can even be structured to provide funds for several generations if there is a desire to establish a legacy of funds for grandchildren and beyond.

A key advantage to using an irrevocable life insurance trust is that it can be established to remove any incidents of ownership that the Settlor or Grantor had in the policy. If the Settlor or Grantor does not have any incidents of ownership in the policy, the policy will generally not be included in the estate of the Settlor or Grantor and therefore not be subject to estate taxation. In order to achieve this advantage, the trust agreement is irrevocable and only the Trustee will have the authority to manage the insurance policy. A Trustee is often granted the power to loan funds to the Estate of the Settlor or Grantor which can be used to pay final expenses such as estate taxes. If the irrevocable life insurance trust is being established to remove incidents of ownership in the policy, then it is advisable to purchase life insurance within the trust itself, if possible. This is because if a policy is transferred to a trust, the Settlor or Grantor must live for three (3) years after the transfer or the policy will be included with the estate of the Settlor or Grantor and be subject to estate taxation.

Clients who have established an irrevocable life insurance trust will be familiar with the Crummey power. The Crummey power is included in the trust agreement whereby the beneficiaries are provided the right by notification to withdrawal all or a portion of the annual additions to the trust. This allows the annual exclusion available for gifts to be possibly applied to the initial transfer of the policy to the trust, as well as the subsequent payment of premiums.

This strategy should be implemented carefully and there are other rules to follow, but the irrevocable life insurance trust may be a key tool especially if estate taxation is projected.