ADVANCED PLANNING

The Power of Irrevocable Life Insurance Trusts

CHALLENGE:

You have a need for the protection offered by life insurance and have an established or potential estate tax liability. You want to protect the amount of wealth your loved ones receive after your death.

STRATEGY:

An irrevocable life insurance trust (ILIT).

HOW AN IRREVOCABLE LIFE INSURANCE TRUST WORKS

An ILIT is an irrevocable trust that serves as both the policy owner and the beneficiary of a life insurance policy. The life insurance policy most commonly insures the life of the individual creating the ILIT, also known as the trust grantor.

At the insured's death, the policy's death benefit is paid to the ILIT, typically income- and estate-tax free. In turn, the proceeds are distributed to heirs as directed by the terms of the ILIT. This strategy allows the life insurance policy's death benefit to bypass the probate process and not be included in the gross taxable estate for federal estate tax purposes. The ILIT beneficiaries can then use the life insurance proceeds to offset any taxes that are due.

During the life of the grantor: The ILIT trustee may have the ability to make distributions from the trust to the trust beneficiaries.

At the death of the grantor: The trust terms dictate how distributions from the trust are made to trust beneficiaries.

AN IRREVOCABLE LIFE INSURANCE TRUST (ILIT) CAN:

- Provide lifetime benefits to a surviving spouse and/or other loved ones.
- Meet the liquidity needs of your estate.
- Minimize income, estate, and gift taxes.

BENEFITS FOR YOU

- Your legacy is preserved, and the size of your taxable estate is reduced.
- You gain more control over how your loved ones receive your wealth.
- You can equalize an inheritance among children and/or other loved ones.

BENEFITS FOR YOUR LOVED ONES

- With less lost to taxes, they're able to enjoy more of their inherited wealth.
- They'll have increased liquidity at a time when it may be needed most.
- They may benefit from creditor protection.

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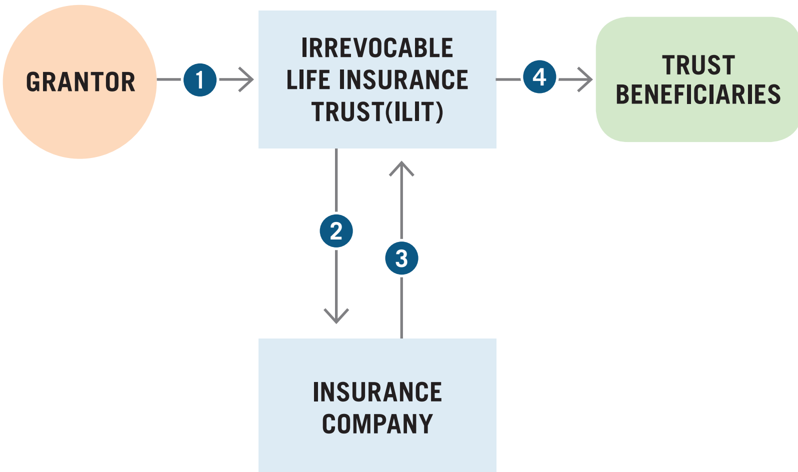
HOW TO GET STARTED

You start by working with an attorney to create the ILIT. Your team of advisors can help guide you as you detail your wishes and name a trustee, the terms of the trust, and the trust beneficiaries.



1. You, as the grantor, fund the trust.[1]
2. The trustee uses the funds to purchase a permanent life insurance policy on your life.
3. **At death,** the life insurance proceeds are paid to the ILIT, typically income- and estate-tax free.[2]
4. **The proceeds are distributed** by the trustee according to the trust terms to your trust beneficiaries.

In order to avoid inclusion of the policy in your estate for estate-tax purposes, you cannot retain any ownership rights, control, or beneficial interest in the trust. It is permissible to transfer an existing life insurance policy to an ILIT, but if you die within 3 years of the transfer date, the policy will be included in your estate for federal estate tax purposes.

CHOOSING A TRUSTEE

When you establish the ILIT, you'll have the ability to select who serves as your trustee, the person or entity who will manage your trust assets according to the wishes you specify in the trust document. To accomplish your wealth transfer goals and avoid having the life insurance policy included in your estate, you, as the grantor/insured, must not be the trustee. However, you can choose an individual or corporate entity to serve as trustee. Be aware though, that if you choose a trust beneficiary to serve as a trustee, then any distributions made from the trust to that trust beneficiary who is serving as trustee may be restricted to distributions for health, education, maintenance, and support.

FUNDING YOUR TRUST

In order to purchase life insurance, your ILIT will need to be funded. The simplest and perhaps the most common way to fund an ILIT is through gifting. There are two important gifting exemption amounts you'll want to be aware of if you're funding an ILIT through gifting:

- **Annual Gift Tax Exclusion** – this is the amount you can gift per person annually without incurring a gift tax, or without affecting the lifetime gift tax exemption. For 2022, the annual gift tax exclusion is $16,000.
- **Lifetime Gift Tax Exemption** – this is the amount you can gift over the course of your lifetime without incurring federal gift taxes. In a given year, any amount you gift to a single recipient that exceeds the annual gift exclusion will reduce your lifetime gift tax exemption amount. For 2022, the lifetime gift tax exemption is $12,060,000.

You can leverage your annual gift tax exclusions when gifting to a trust, as you can gift up to the annual exclusion value to each beneficiary of the trust without incurring gift taxes. For example, if in 2022 you establish an ILIT with four trust beneficiaries, you can gift $64,000 annually to the trust without using any of your available Lifetime Gift Tax Exemption.

However, a gift to a trust will only qualify as an annual exclusion gift if there is a transfer of a "present interest" in the property. "Present interest" is transferred when there is unrestricted right to the immediate use, possession, enjoyment of property, or the income from property.[3] In the case of an ILIT, gifts you make to the trust are typically considered present interest gifts if your trust beneficiaries have the power to withdraw contributions for a limited period of time. This power is called "Crummey power."

Should your circumstances require it, there are more advanced strategies to fund an ILIT, including financing strategies, loan arrangements, and other estate planning strategies.

BUILDING UPON THE FOUNDATION

An ILIT can be the foundation for a more specialized trust with the addition of various trust provisions and/or language. Specialized trusts can help you achieve more sophisticated planning goals or address any unique needs you may have. These include:

- **Spousal Lifetime Access Trust (SLAT)** – A spousal lifetime access trust (SLAT) is a specially drafted ILIT for married couples. SLATs are designed to keep life insurance proceeds outside the taxable estate of both spouses and still allow indirect access to trust assets to the non-grantor spouse through an independent trustee.
- **Dynasty Trust** – A dynasty trust is an irrevocable trust designed to last for many generations with the goal of transferring as much wealth as possible while minimizing the impact of Generation-Skipping Transfer Taxes and federal estate taxes.
- **Grantor Trust** – A grantor trust, that is drafted as an intentionally defective grantor trust (IDGT) is specifically structured to be excluded from the grantor's estate for federal estate-tax purposes, but owned by the grantor for income-tax purposes.[4] Grantor trusts can be leveraged as part of more sophisticated strategies, including those where income producing assets such as stock or real estate are used as part of the trust funding.

If you'd like to explore how an ILIT might help you achieve your goals, contact your financial professional to get started.

[1] There may also be federal gift tax consequences associated with the funding of an ILIT.

[2] Per IRC §101(a).

[3] Per Treas. Reg. §25.2503-3(b).

[4] Per IRC §671-679 and IRC §2036-2038.

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