Gifting a Life Insurance Policy to Multiple Owners

Clients hesitant to establish an irrevocable life insurance trust (ILIT) may want to explore alternative approaches to removing a sizable life insurance policy from their estate. One idea that can arise is gifting the policy to family members instead of establishing the ILIT. But if the client wants to involve more than one donee, e.g., a parent wanting to transfer ownership equally to multiple children to avoid making a single, large gift, there are consequences they should be made aware of.

Pitfalls of Joint Gift Recipients

A client may think they can reduce or avoid gift tax when transferring a policy to multiple owners by leveraging the annual gift tax exclusion ($17,000 in 2023) and potentially gift splitting with a spouse ($34,000). However, it's important to understand the gift tax rules to explain to clients why this may be undesirable.

Put simply, the annual gift tax exclusion can be claimed only for transfers of a present interest in property. This means that the donee must have the right to control and enjoy the property immediately after the gift. If a donee's control and enjoyment is contingent on the agreement of the other donees, the annual gift tax exclusion may not be available. This is where the issue arises.

A jointly owned life insurance policy requires the consent of every owner to exercise rights in the policy. Because each individual donee does not have an unrestricted right to the policy, the transfer may not qualify for the annual gift tax exclusion. As a result, the transfer may instead be a reportable taxable gift. If the donor client has enough federal lifetime gift tax exemption remaining to cover the transfer, this would not result in gift tax; if they don't, a tax of up to 40% of the gift's value may be due.

The Case for an ILIT

Although clients may be hesitant to establish an ILIT, in this scenario an ILIT can help a client achieve their goals:

1. Removing the policy from the owner's estate,
2. Taking advantage of the annual gift tax exclusion, and
3. Ensuring that multiple beneficiaries will receive the policy proceeds.

Unlike gifting a life insurance policy to multiple beneficiaries, transferring a life insurance policy to an ILIT can qualify as a present interest gift to each of them when the trust includes Crummey withdrawal rights.* With these rights, the trust beneficiaries are given the ability to withdrawal their pro rata share of the gift (the policy cash value or trust property of equivalent value) during a specified time period. This gives the beneficiaries an immediate right to enjoy the trust contributions, qualifying the transfer for the annual gift tax exclusion.

Summary & Support for Your Next Case

When the goal is to remove the policy from the owner's estate, minimize transfer taxes, and ensure that multiple beneficiaries will receive the policy proceeds, an irrevocable life insurance trust is often a better solution than direct ownership by multiple individuals.

Prudential's Advanced Planning team is here to support you and help you close your next case. For questions regarding ILITs, trust planning or any advanced concept or strategy, please contact Prudential's Advanced Planning team at 800-800-2738, option 4.

*Crummey v. Commissioner of Internal Revenue, 397 F. 2d 82 (9th Cir. 1968)

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