



Wealth Transfer Planning

The Irrevocable Life Insurance Trust (ILIT)

At some point in time the financial fruits of your labor, the wealth you have spent a lifetime building, will pass on to someone else. The legal system allows you to decide when you want to pass it on, to whom you wish to pass it on to, or if you want to leave it up to the government, the intestate laws of your state, or your heirs to figure it out.

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Consider what a well-designed estate plan may accomplish:

- ✓ Minimize federal and state transfer taxes (estate, gift and generation skipping taxes)
- ✓ Protect property from potential creditors (judgment creditors, bankruptcy, divorce, etc.)
- ✓ Assure assets and property end up in the right hands
- ✓ Avoid the potentially negative impact sudden wealth may have on heirs
- ✓ Avoid family strife / fighting over the estate
- ✓ Avoid mismanagement of the estate by heirs
- ✓ Avoid probate (minimize cost and time, retain privacy)
- ✓ Provide support for a charitable organization

The Liquidity Need

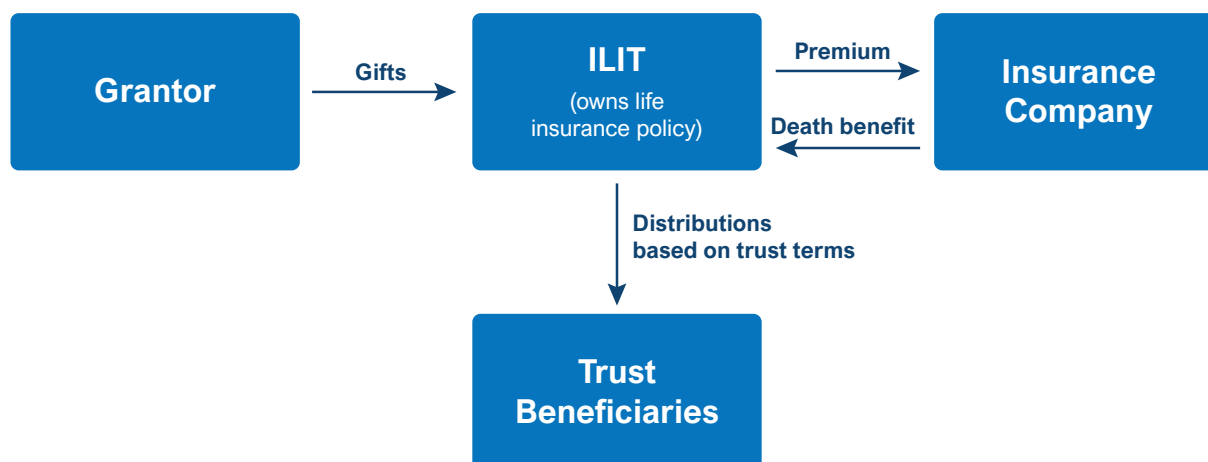
Beyond planning for the who and when, you also have control over what you pass on. One consideration for an effective estate plan is the need for your heirs to receive sufficient liquidity. Liquid funds may be needed to:

- ✓ Avoid the need to sell assets to pay federal and/or state level estate taxes
- ✓ Purchase a business interest pursuant to obligations under a buy-sell agreement
- ✓ Allow the next generation to continue and grow the family business
- ✓ Equalize family members who will not receive a share in the family business
- ✓ Provide for the financial income needs of a surviving spouse

The Irrevocable Life Insurance Trust (ILIT)

Life insurance may play a key role in providing such liquidity. The estate planning advantages of life insurance may be enhanced by having the policy owned by an irrevocable life insurance trust (ILIT). An ILIT is a separate entity designed to own the policy and receive the death benefits. The trustee is given control over the policy and will be responsible for carrying out the terms of the ILIT for the benefit of named beneficiaries (typically the insured's spouse, children or other family member). It is a flexible document, in that the grantor (the individual who establishes and funds the trust), may decide how the trust will operate during their lifetime and how trust income and property will be distributed after their death.

One issue with the insured directly owning the policy is that the death benefit will be included in their estate for estate tax purposes. When an ILIT owns the policy and, the policy is designed and administered properly, the death benefits will be excluded from the insured's estate.



Adding Flexibility

One challenge in developing an estate plan is that you're aiming at a moving target – family dynamics may change, financial needs may change, your goals may change and tax laws will most certainly change. An ILIT may be designed to add flexibility to address these potential changes. For example:

- + The trustee may be given the right to “swap” assets – For example, if the grantor would like to remove a life insurance policy from the ILIT, the trustee and grantor may agree to swap ownership of the policy back to the grantor in return for assets of equal value.
- + The trustee may be given the right to loan money to the grantor and/or trust beneficiaries.
- + A beneficiary may be given a limited power of appointment which grants them the right to name the party to receive their interest in the trust after they pass away.
- + A trust protector may be named – This is an individual or entity that is granted the right to make trust changes in order to assure the grantor's wishes are carried out. Duties are spelled out in the trust and may be broad or limited. The trust protector may be given the power to modify the terms of a trust and address unforeseeable events such as changes in tax laws or family dynamics.
- + The insured/grantor may be named as a trustee with a right to manage trust property other than the life insurance policy.
- + The ILIT may be terminated or modified based on state laws. A termination or modification may require the signatures of all beneficiaries, the grantor and the trustee.
- + In some states the ILIT may be permitted to go through the process of decanting, which involves taking all the principal out of the existing ILIT and placing them in a new ILIT with provisions that are more suitable to the grantor's goals.
- + The grantor and/or the beneficiaries may be given the right to change trustees. Pursuant to IRS Revenue Ruling 95-58, the right to remove the trustee does not cause estate tax inclusion as long as the new trustee is not a “related or subordinate party.”
- + The trustee (or a trust protector) may be given the right to change trust situs (i.e. governing state law) – This may be appropriate in order to take advantage of laws in different states that may be more beneficial.
- + A spouse may be included as a beneficiary, and the trustee given the discretion to distribute income to the spouse (typically limited to distributions for health, education, maintenance and support – which may be broadly defined).

“ The only constant in life is change. ”
— Heraclitus

Considerations

- ✓ Even though the ILIT is a flexible document, it is irrevocable. As mentioned above, the ILIT may be terminated or modified, but a termination of the ILIT does not result in trust income or property reverting back to the grantor.
- ✓ When the grantor pays premiums on the life insurance policy it will be deemed a gift for federal gift tax purposes. Gift taxes may be avoided by applying the annual gift tax exclusion (\$18,000 per trust beneficiary in 2024) and/or using their lifetime gift/estate tax exemption (\$13.61 million in 2024).
- ✓ The insured should not have any rights as a trustee over the life insurance policy. This would cause the death benefit to be included in their estate for estate tax purposes.
- ✓ There are costs (i.e. legal fees, potential trustee fees and costs associated with estate planning professionals) to establish and administer an ILIT.



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