

**Irrevocable Life Insurance Trusts can protect loved ones
from costly taxes or provide needed liquidity to an estate.**

An Irrevocable Life Insurance Trust (ILIT) can be a valuable estate planning tool. When carefully prepared, it is a means of transferring life insurance proceeds to a beneficiary or beneficiaries tax-free. This type of trust can also provide liquidity to an estate, so that the cash resulting from the insurance proceeds can be used to pay taxes, expenses, and debts related to assets remaining in the Grantor's estate. Properly structured, it can provide benefits to the insured's surviving spouse without being included in his or her gross estate.

Typically the initial phase requires that the person who sets up the trust (the Grantor), take a few simple steps to get started:

- give direction as to the beneficiaries of the insurance policy.
- select initial and successor trustees
- instruct how the life insurance proceeds are to be managed after the Grantors death.
- specify whether the trustee will be able to exercise his discretion with the insurance assets.

The trustee's main function is to carry out the Grantor's wishes as set forth in the trust document. A neutral party is often appointed by the grantor to be trustee of the ILIT. The trustee is usually a trusted professional, such as a bank, trust company or attorney. The Grantor can appoint more than one trustee to serve at the same time. The Grantor may appoint a trusted professional along with a family member (Co-Trustees), so that the family goals are met while the trust assets are under the expert guidance of a professional.

Timing makes a difference.

Once the initial phase of the ILIT is accomplished, the attorney drafts the insurance trust, the trustee and the insured sign it, and the trustee applies for the life insurance policy. An existing policy can be transferred to a life insurance trust, but it is important to note that the tax code provides that if the insured dies within three years of transfer of an existing life insurance policy to an ILIT the proceeds will be included in the insured's estate for tax purposes.

If the insured is married, a fail-safe clause is normally written into the trust so that upon the death of the insured prior to the running of this three-year period, the ILIT proceeds are held separately and administered for the benefit of the surviving spouse qualifying for the estate tax marital deduction. The proceeds will be tax free to the surviving spouse, but the proceeds left at the surviving spouse's death will be included in his or her taxable estate. If the insured dies after the three year period, this fail-safe clause does not apply.

Once the trust is formed it's out of the Grantor's hands.

Once the ILIT has been created, successors have been defined, and a fail-safe clause has been set (if needed) that the Grantor gives up all power over the trust and life insurance policy, thus making it irrevocable.

The insurance trust cannot be rescinded, amended, or changed in any way after its formation. The insured becomes separate from the ownership of the policy insuring his or her life and the ILIT now owns the policy. The money transferred to the ILIT each year by the Grantor is used by the Trustee to pay the premiums on the life insurance policy. This premium payment takes advantage of the annual gift tax exclusion, which in 2009 became \$13,000.00 per person. The premium paid each year is considered a gift to the beneficiaries of the ILIT. As long as the premium payment total is no more than \$13,000.00 per beneficiary, no gift taxes will be due. Also, for the gift tax exclusion to be effective, the beneficiaries need to have a "present interest" in the funds. In order to

satisfy the “present interest” requirement, the beneficiaries are given written notice (called Crumney Notices) that money was deposited in the ILIT and they have 30 days to withdraw this money from the trust. The Crumney Notices also state that the beneficiaries know the purpose of the ILIT and refrain from withdrawing their funds. This then allows the Trustee to pay the insurance premium.

At the death of the Grantor, the life insurance pays the death benefit, which is income-tax-free, as well as tax-free on the Grantor’s estate. The proceeds can be used to pay estate taxes and/or the ILIT can continue to hold money for the future benefit of beneficiaries following the wishes that the grantor made at the creation of the ILIT.

If you are considering an Irrevocable Life Insurance Trust, email Attorney [Tracey Anderson](#) or call him at **574-232-3538**. He can help you understand the pros and cons, and create a plan that works for you and your beneficiaries. We offer a free initial consultation to discuss your estate planning needs.

To learn more about estate planning visit the [South Bend law firm](#) of Tuesley Hall Konopa, LLP.



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A CPA who also has earned a special legal degree in taxation (LL.M.), Tracey maintains an intricate knowledge of tax laws and their specific application to businesses and individuals.

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Disclaimer

This article is for informational purposes only and should not be relied upon as legal advice. If you are considering the preparation of an Irrevocable Life Insurance Trust you should seek the advice of a legal professional.