Eagle Strategies LLC

Estate

PLANNING ESSENTIALS

The Importance of Irrevocable Life Insurance Trusts

Given the current historically high lifetime gift and estate tax exemption limits, $11.7 million per individual ($23.4 million for a married couple),[1] this might make ILITs seem like an unnecessary step for most people. However, if Congress takes no action, the current lifetime exemption limits are set to revert back to $5 million per person in 2025 (adjusted for inflation). Many are calling for even stricter limits—advocating for a restoration of 2009 estate and gift tax levels: $3.5 million per person for the estate tax; $1 million for the gift tax; and a top tax rate increase to 45%.

Considering this uncertainty, more individuals and families may want to explore the potential future benefits of including an ILIT as a fundamental component of their estate plans.

KEY TAKEAWAYS:

1. ILITs provide a tax-efficient way to transfer wealth to your beneficiaries outside of your taxable estate.
2. They're also an effective mechanism for protecting legacy assets from potential creditors for both you and your beneficiaries.
3. If you're planning to provide for continued care for a family member with special needs , an ILIT can help you earmark assets for their care without interfering with their eligibility for government benefits.

How do ILITs work?

ILITs are trust structures that are established to purchase and own a life insurance policy on the grantor's life. There are three legal parties to the trust:

- ***The Grantor*** – the person who creates and funds the trust;
- ***The Trustee*** – the individual or organization that manages the trust and assumes responsibility for paying annual insurance premiums and overseeing trust administration; and
- ***The Beneficiary(ies)*** – the individual(s) who will receive the trust assets upon the grantor's death.

Effectively, by creating an ILIT you're separating the value of the assets your trust owns from the value of your taxable estate. The trustee (which can be a friend, relative, or professional independent trustee) coordinates the payment of premiums with the insurance provider to ensure the policy remains in force. When you die, the policy's death benefit is then paid directly to your trust, which in turn distributes the proceeds to the trust's beneficiaries.

The only major downside is that ILITs are irrevocable trusts. Whereas a revocable trust can be easily modified or terminated because the assets are still considered a personal asset, you relinquish control over assets when you gift them to an irrevocable trust. Therefore, the trust cannot be modified without the consent of the beneficiaries.

Annual policy premium payments

One of the most tax-efficient ways to pay the annual insurance policy premiums is to use your annual gift tax exclusion (currently $15,000 per year for each trust beneficiary) to fund the trust each year. Once the funds are received by the trust each year, your beneficiaries would receive a written notification (these are called "Crummey Notices") allowing them the option to take those funds as a distribution. Understanding the purpose of the trust, they would then decline the withdrawal—making the funds available for the trustee to pay the required insurance premiums.

Alternatively, you could simply transfer an existing insurance policy to an ILIT. It's important to note, however, that should you die within three years of transferring the policy to the trust, the IRS would require that any proceeds be included in your estate for estate tax purposes.

Additional estate planning benefits of ILITs

Aside from the tax-efficient transfer of wealth to your beneficiaries, there are two other important benefits of ILITs which may be of value based on your partiular circumstances:

1. **Asset protection –** Although each state has its own rules regarding exactly how much insurance policy cash value or death benefit can be protected from creditors, when the policy is held in an ILIT any excess value above those limits is generally protected from the creditors of both the grantor and the beneficiary. This can be especially beneficial if you or your beneficiaries are in highly litigous professions.

2. **Government benefit protection –** For those seeking to provide lifetime care for a family member with special needs, careful estate planning is essential. Using an ILIT can help ensure that inherited assets don't inadvertantly interfere with a beneficiary's eligibility for government benefits such as Social Security disability income or Medicaid. By carefully controlling how distributions from the trust are used, the trustee can ensure that continued benefit eligibility is maintained.

ILITs are powerful planning tools that may serve as an important wealth transfer mechanism in many well-crafted estate plans. They afford a multitude of potential benefits to your family, with few drawbacks aside from the irrevocable nature of the gift and the need to ensure you have the means to continue paying annual premiums to keep the insurance policy in force.

In light of the uncertain future of estate tax exemptions and rates, now may be an opportune time to determine whether an ILIT may benefit your overall financial plan.

[1] 2021 Estate Tax Rates, IRS.gov.

ES.PE.IrrevocableLifeInsuranceTrusts
SMRU 1916637 (Exp. 10/31/2023)

Eagle Strategies LLC

PROTECTION. RETIREMENT. INVESTMENT. ESTATE.

Trusted Guidance. Comprehensive Solutions.