

Tax Planning Tips Irrevocable Life Insurance Trusts

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Few people realize that, even though they may have a modest estate, their families may owe hundreds of thousands of dollars in estate taxes because they own a life insurance policy with a substantial death benefit. This is because life insurance proceeds, while not subject to federal income tax, are considered part of your taxable estate and are subject to federal estate tax.

The solution to this problem is to create an irrevocable life insurance trust that will own the policy and receive the policy proceeds on your death. A properly drafted life insurance trust keeps the insurance proceeds from being taxed in your estate, as well as in the estate of your surviving spouse. It also protects the trust beneficiaries from their own “excesses”, against their creditors, and in the event of divorce. Moreover, the trust also provides reliable management for the trust assets. Here's how the irrevocable life insurance trust works.

You create an irrevocable life insurance trust to be the owner and beneficiary of one or more life insurance policies on your life. You contribute cash to the trust to be used by the trustee to make premium payments on the life insurance policies. If the trust is properly drafted, the contributions you make to the trust for premium payments will qualify for the annual gift tax exclusion, so you generally won't have to pay gift tax on the contributions.

The life insurance trust typically provides that, during your lifetime, principal and income, in the trustee's discretion, may be paid or applied to or for the benefit of your spouse and descendants. This allows indirect access to the cash surrender value of the life insurance policies owned by the trust, and permits the trust to be terminated if desired despite its being irrevocable. On your death, the trust continues for the benefit of your spouse during his or her lifetime. Your spouse is given certain beneficial interests in the trust, such as the right to income, limited invasion rights, and eligibility to receive principal. On the death of your spouse, the trust assets are paid outright to, or held in further trust for the benefit of, your descendants.

If you own a life insurance policy with a significant death benefit, an irrevocable life insurance trust may be of substantial benefit to you. Please contact us for an initial consultation on these and other estate-planning matters.