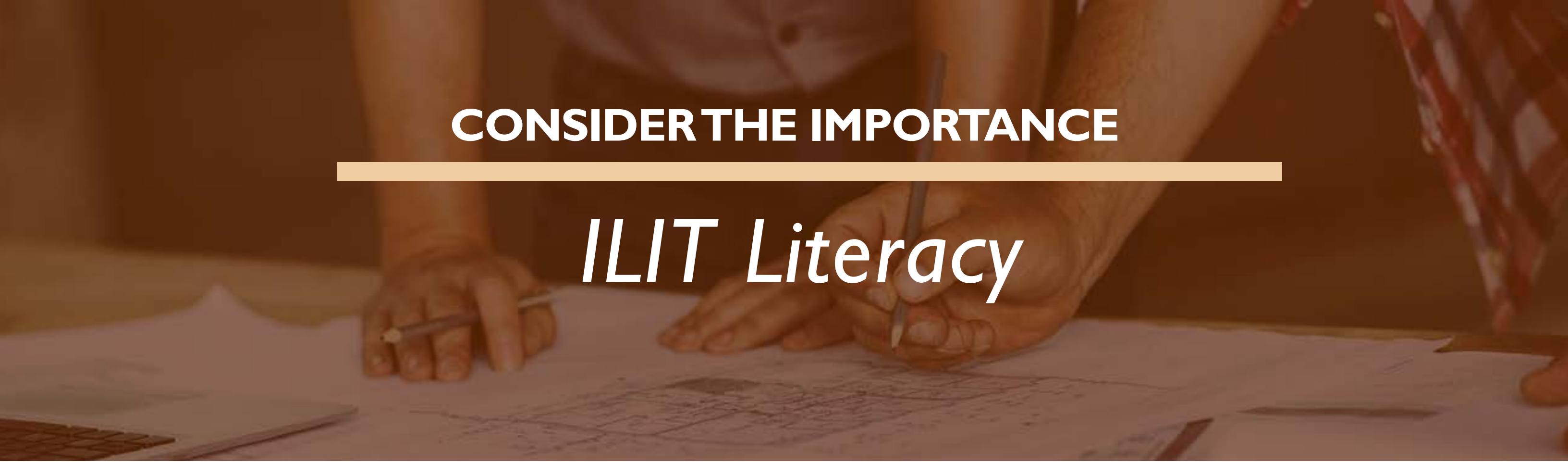

CONSIDER THE IMPORTANCE

ILIT Literacy

By Sean J. Link, J.D.

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Estate planning is a crucial aspect of financial management that ensures the smooth transfer of assets to beneficiaries while potentially minimizing the burden of estate taxes. One effective strategy to achieve these goals is through the use of Irrevocable Life Insurance Trusts (ILITs), powerful tools that can help individuals reduce estate taxes and serve to protect assets that may be difficult to sell. As the forthcoming sunset of the estate and gift tax exemption moves ever closer, focus on these goals is understandably increasing. Let's take a look at the concept of ILITs, how they work, and the significant benefits that they can offer in estate planning.

UNDERSTANDING ILITs

An Irrevocable Life Insurance Trust is a specialized trust designed to hold and manage life insurance policies for the benefit of the trust's beneficiaries. The primary purpose of an ILIT is to ensure that proceeds (*i.e.,* death benefit) from the life insurance policy are excluded from the insured's taxable estate upon their death. This exclusion mechanism can serve to significantly reduce potential estate tax liabilities (at both federal and state levels) and provide financial security to the beneficiaries.

The key components of an ILIT are:

1) <u>Grantor:</u> The grantor is the individual who creates the ILIT and transfers assets into it. Once the ILIT is established, the grantor relinquishes control over the trust and the assets placed within it.
2) <u>Trustee:</u> The trustee is responsible for managing the ILIT and its assets, including premium payments for the life insurance policy and overseeing policy performance.
3) <u>Beneficiaries:</u> The beneficiaries are the individuals and/or entities who stand to receive (or benefit from, if the death benefit is to be retained in trust) the proceeds from the life insurance policy upon the insured's death.
4) <u>Policy:</u> The ILIT owns the life insurance policy on the insured's life and collects the proceeds upon the insured's death. Often, the grantor is the insured.

HOW DOES THIS HELP WITH ESTATE TAXES?

One of the primary advantages of employing ILITs in estate and legacy planning is the ability to mitigate estate taxation in the following ways:

1) Removing policy proceeds from the taxable estate: Once an ILIT is created, the life insurance policy can be owned by the trust rather than the insured individual. As a result, policy proceeds are not included in the grantor's taxable estate upon their death, provided that the grantor survives the three-year lookback period after transferring a policy to the ILIT. If the insurance and trust planning are performed in concert, ideally an ILIT can own the policy from its inception and the lookback period is a non-issue.
2) Leveraging the Annual Gift Tax Exclusion: A grantor can make annual gifts to the ILIT (through what is known as the "Crummey" process) to cover the premium payments for the life insurance policy. These gifts can typically be structured to fall within the annual gift tax exclusion amount, which is periodically adjusted for inflation. This strategy allows the grantor to reduce their taxable estate while funding the policy within the trust, thereby achieving great leverage of the initial annual gifts.
3) Using the Lifetime Estate and Gift Exemption: In addition to annual gift exclusions, a grantor can also use some or all of their lifetime unified estate and gift tax exemption to make larger gifts to an ILIT without incurring gift taxes. This also reduces the taxable estate and provides the opportunity for leveraging such gifts through premium payments and/or intra-trust investment.

HARD TO SELL, BUT EASIER TO PROTECT

ILITs can also offer a unique advantage when it comes to safeguarding assets that are difficult to sell or illiquid, such as family businesses, real estate holdings, or other investments not easily converted to cash. Here is how an ILIT can help protect such assets:

1) Liquidity for Estate Expenses: Upon the death of the insured, the ILIT will receive the death benefit proceeds. These funds can be used to cover estate taxes and other expenses without the need to hastily sell assets (including illiquid or hard-to-sell assets). An ILIT is often drafted so that the trustee can purchase assets from the estate, providing a much-needed influx of cash to settle the estate's financial obligations without compromising the long-term value of any estate assets.
2) Preservation of Family Businesses: For families with a closely-held business, a similar structure as described above can provide liquidity for estate taxes, allowing the family to retain ownership and control of the business. Without such planning, estate taxes might force the sale of the business to meet the estate's financial obligations (including taxes), potentially leading to the business's fragmentation or dissolution.

3) Real Estate Holdings and Investments: ILITs can also hold interests in real estate or investment assets. By having the trust also hold life insurance, the grantor can help to ensure that the trust beneficiaries receive desired assets, as death benefit proceeds will provide a buffer between meeting financial obligations and selling assets that otherwise were earmarked for the beneficiaries.

WHERE DO WE GO FROM HERE?

Irrevocable Life Insurance Trusts are obviously a powerful estate and legacy planning tool that can help individuals reduce estate taxes and protect assets that are challenging to sell. By strategically deploying an ILIT and insurance planning, individuals can exclude life insurance policy proceeds from their taxable estate, leverage gift tax exclusions and exemptions, and ensure that beneficiaries receive the financial security they need through the assets intended for them.

Common objections to ILIT strategies are often born from an incomplete understanding of exactly how ILITs operate and, more importantly, *why* they can be so effective in estate and legacy planning. Helping a client to appreciate the flexibility and efficacy of ILITs can and should be paramount to implementing such strategies.

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