

Utilizing Irrevocable Life Insurance Trusts

Estate planning attorneys and tax advisors often advise affluent families to consider using life insurance in their estate plans. An important consideration in acquiring life insurance for estate planning purposes is the manner in which the life insurance policy will be owned.

It is important to note that, if the policy is personally owned at the time of death, proceeds from the life insurance policy can be included in the estate for tax purposes. This has the potential effect of increasing the size of the estate and may cause additional taxes to be incurred. A more practical and tax-efficient solution may be to set up an Irrevocable Life Insurance Trust (ILIT) to own the policy.

How Does an ILIT Work?

Step 1: Establish an ILIT

A qualified estate planning attorney generally drafts the ILIT document specifying the terms and conditions of the trust and naming a fiduciary (the trustee) responsible for managing the trust's assets for the benefit of the trust's ultimate recipients (the trust beneficiaries).

Step 2: Fund the ILIT

The trust is funded with cash (see Funding the ILIT below), which the trustee will use to purchase the life insurance policy.

Step 3: Purchase the Life Insurance Policy

The trustee will use the funds from the ILIT to purchase the life insurance policy on either the life of the person establishing the trust (the grantor) or the grantor and the grantor's spouse. The trust is named as owner and beneficiary of the life insurance policy and the grantor's heirs are typically named as beneficiaries of the trust.

Funding the ILIT

There are two primary strategies for funding an ILIT: gifts and loans.

Gifts

Under current tax laws (2015), an individual may make gifts of up to \$14,000 per year per recipient without incurring gift taxes (annual exclusion gifts). In addition, an individual may transfer up to \$5,430,000 over their lifetime in gifts which do not qualify for the annual exclusion (lifetime exemption gifts), free of transfer taxes.

Note: when annual exclusion gifts are made to an ILIT, these must be carefully structured to protect them from gift taxes. An experienced life insurance professional can assist individuals wishing to use annual exclusion gifts to fund an ILIT.

Life insurance due care requires an understanding of the factors that impact policy performance and drive product selection.

M Financial Group continues to lead the industry in life insurance due care and client advocacy, providing valuable insight and analysis that delivers significant value to clients.

Keeping Life Insurance Outside of the Taxable Estate with an Irrevocable Life Insurance Trust (continued)

Loans

In addition to a gifting strategy, individuals may make interest-bearing loans to an ILIT. These loans must be properly structured and managed in order to avoid unintended tax consequences. An experienced life insurance professional may assist in designing such an arrangement.

Both strategies are commonly used and may be used in tandem to fund the ILIT.

At Time of Death

At death, the life insurance policy proceeds are paid to the trust. The trustee may use these funds in a variety of ways. If the ILIT document allows, the trustee may be able to lend cash to the estate of the deceased. In an alternative method, the ILIT trustee may be authorized to purchase assets from the estate. Either method will create liquidity for the executor of the estate to meet the estate's financial needs. These needs may include satisfying unpaid debts, estate administration expenses (such as probate), funeral expenses, and end of life medical care costs. The executor may also use these funds to make planned bequests and to pay any Federal and State income and transfer taxes that may be due.

Benefits of Life Insurance Held in an ILIT

- **Estate Liquidity:** Cash is made available exactly when it is needed... at the time of death.
- **Potential for Growth:** Policy death benefits exceed the total premiums paid.
- **Centralized Policy Management:** Decisions made regarding the policy are carried out by the trustee selected by the grantor.
- **Creditor Protection:** Trusts may provide protection from the claims of creditors (both the grantor and the trust's beneficiaries).
- **Valuable Tax Benefits:** Death benefits are income tax free and, if held in a properly structured ILIT, free of transfer taxes.

For More Information

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