Creating and Maintaining Your ILIT

Irrevocable life insurance trusts (ILITs) can be an integral part of your total estate plan. As with any trust, it is important to periodically review the ILIT to consider whether the reasons for the creation of the trust still exist, that the underlying insurance policy is performing as intended when purchased, and that the trustee is properly administering the trust.

ILITs are generally created to provide cash for the beneficiaries of the trust at the death of the insured. Common requirements for cash are to pay federal and state estate taxes, provide for the transition of a family business to one or more select children while ensuring equal inheritances to the other children, and education of grandchildren. While there has been much discussion on the recent estate tax changes eliminating estate taxes for the vast majority of Americans, there are two things to bear in mind: first, you may be one of those few who still have a taxable estate: and, secondly, the current estate tax laws, which may be modified by subsequent Congresses, may not be in effect on your death. If your rationale in creating an ILIT was the transition of a family business, you may have already transitioned the business during your life or have had a change of heart by the children who were supposed to inherit the business. Given the increasingly higher cost of college and graduate school, chances are the educational expenses of your grandchildren will only increase; however, if they are already educated or have decided not to pursue higher education, your ILIT needs may have changed. If you are considering letting an insurance policy owned by an ILIT lapse, bear in mind that once a policy lapses, you cannot reinstate it. You should discuss your ILIT or need for an ILIT with your financial advisor and attorney to determine your proper course of action.

With respect to whether the insurance policy held by the ILIT is performing correctly, your financial advisor should review both the status of the company issuing the policy and the performance of the policy. Your insurance company should have a proven track record of low premiums and high credit ratings so that you are confident they will not go out of business prior to paying the death benefit. Additionally, most ILITs are funded with whole life or universal life policies. If a universal life policy is used, be sure to review the investment options selected and the guaranteed return versus the actual return achieved on the policy. Whole life policies can accumulate significant cash values which can be accessed during the insured's lifetime. Instead of purchasing a new policy for your ILIT, you may transfer policies you already own to the trust. However, if you do so, you must survive three years from the date of transfer, or the proceeds will be included in your taxable estate. There may also be gift tax consequences of transferring existing policies that your advisor or attorney can explain.

Choosing the correct trustee for your trust is an important decision. If you and your spouse are both insureds of the trust, neither one of you can serve as the trustee. A corporate trustee is the best solution to ensure that the administrative requirements of the trust meet the standards mandated by the IRS. These duties include accepting your premium payments and making sure they are made in a timely manner to prevent lapse of the policy, and preparing and filing any fiduciary tax returns that may be required. The trustee also prepares and transmits "Crummey Letters"; these are required notices to the beneficiaries that a contribution has been made to the trust and give them the right to request withdrawal of their share of the contributions within a specific period of time. This qualifies the premium contribution as an annually-excluded gift (the 2018 annual exclusion is $15,000 per beneficiary). Of course, should the beneficiaries elect to withdraw, there would be insufficient funds to pay the premium, and the policy would lapse. The trustee can assist with the education of the beneficiaries in this matter. Placing all of these matters in the hands of a professional means that all legal and tax requirements will be performed.

Finally, you should consider the needs of the beneficiaries of your ILIT after the policy proceeds are paid. As with any trust, you as the grantor control the terms upon which distributions of the funds are made after your death. Considerations such as creditor protection, a spendthrift beneficiary, and divorce of the beneficiary all can come into play. Also, if one of your beneficiaries receives government benefits, being a beneficiary of a funded ILIT could disqualify them from receiving those benefits unless specific language is inserted in the trust document. Your advisor and attorney can assist you with discussing and implementing solutions for specific family problems.

Connect with us to learn more

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