Irrevocable life insurance trusts

By Shivon Patel, Esq.

Many individuals are not aware that life insurance death benefit proceeds are part of their taxable estate, and can potentially increase the amount of estate taxes that must be paid. Federal estate taxes are expensive and they must be paid in cash, usually within nine months after the date of your death. Since very few estates have this kind of cash, estate assets often have to be liquidated. If you plan ahead, however, estate taxes can be substantially reduced or even eliminated.

An irrevocable life insurance trust (ILIT) allows you to reduce your estate taxes so more of your assets can go to your loved ones. For example, suppose a father owns a $500,000 life insurance policy and subsequently passes away, with his wife and two children as beneficiaries under the policy. The $500,000 death benefit is not taxable to his wife and children as income, but it is generally taxable as part of his gross estate. Such taxation may reduce the amount available to support his children and wife after his death.

The ILIT is useful in this situation because it allows the death benefit to avoid estate taxation by removing the father's "incidents of ownership" over the life insurance policy. The ILIT owns your life insurance policy for you, and is the life insurance beneficiary for the death benefit proceeds. Since you do not own the life insurance policy, the death benefit proceeds will not be included in your estate. The trustee makes the premium payments and must follow the instructions you put in your irrevocable life insurance trust document, therefore providing you utmost control over your policy and death benefit proceeds.

Individuals interested in utilizing these trusts should be aware of the potential tax pitfalls associated with improper planning. One major pitfall relates to an IRS rule that taxes life insurance death benefits to the estate if the owner of the policy dies within three years of transferring the insurance policy to the ILIT. Therefore, it is preferable, if possible, for an individual to first establish an ILIT and then allow the ILIT to purchase the life insurance policy.

Another area of concern is associated with gift taxation. If you transfer an existing policy that has a cash value to an ILIT, gift taxes may be due. The ILIT is considered a separate entity, so any funds contributed to such a trust will be considered gifts subject to gift taxes. This also includes amounts contributed to pay the insurance premiums. A properly drafted ILIT, however, will normally include language that alleviates some of the negative effects of gift taxation by efficiently utilizing the annual exclusions available.

ILITs are used extensively in estate planning because they remove assets from an individual's estate, thus reducing estate taxes. An ILIT should be drafted an estate planning attorney to ensure compliance with state and federal laws and proper tax planning should be done in advance. Properly designed and implemented, ILITs allow a surprisingly high degree of flexibility coupled with significant estate planning benefits.

Shivon Patel is an attorney with The Principal Law Firm in Sanford, Florida. Her practice areas include business law, real estate, and estate planning. To learn more about The Principal Law Firm, visit www.principallaw.net. LML

Old friends,co-workers celebrate 20-year reunion

Twenty years ago Chili's was one of a handful of restaurants on Lake Mary Boulevard. Things have changed quite a bit in two decades, but 15 former employees of the restaurant recently took a trip down memory lane and attended a 20th reunion at the restaurant where they all once worked. After catching up on everyone's family status, careers, and the fact that many still live right here in Lake Mary, the conversation quickly turned to laughs and nostalgia. Even the current restaurant staff was charmed by the rambunctious group.

Kimberley Waxman, Ryan King. Scarlett Henning, Kim Batchellor, Rex Walker, Amy Ortiz, Renee Scotty, Pete Coffin, Chris Tursini, Christina Crowley, Tara Pinard