

## Setting an estate plan through irrevocable life insurance trusts

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Although most middle-class Americans realize the importance of reducing the value of their estate for estate tax purposes, many have accumulated more wealth than they realize and need to understand the ramifications.

The current estate tax exemption for every American is \$2 million in 2008, which is set to rise to \$3.5 million in 2009. Though plans call for the estate tax to be repealed in 2010, it's set to return in 2011 at a much lower exemption value of \$1 million.

It's not uncommon to find many Americans have purchased large life insurance policies to protect their families in the event of an untimely death, but have overlooked the importance of understanding who should own the policy. This simple mistake can wind up being very costly, because the death-benefit payout from a life insurance policy often exceeds the estate tax exemption.

One solution that can help to address the estate tax problem — and possibly provide many additional benefits — is the irrevocable life insurance trust (ILIT). Because the ILIT actually owns the life insurance policy, the death-proceeds benefit can avoid estate tax exposure.

An ILIT is established with someone other than the insured being named as trustee. Typically, the trustees are the beneficiaries of the trust or some other responsible party. The trustees are charged with following the instructions set forth in the trust document.

A properly established ILIT provides the insured with control over the distribution of the proceeds of the life insurance policy, but keeps the policy proceeds out of the policy owner's insured's estate at the insured's death.

What is a trust? It's simply a legal entity that can hold title to property for the benefit of one or more other persons or entities. The trustee is the person or entity that's responsible for managing the trust.

What is an irrevocable life insurance trust?

Created during one's lifetime, an ILIT is a type of irrevocable trust set up specifically to hold and own a life insurance policy as the primary trust asset. The ILIT also is des-



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igned as the beneficiary on the insurance policy so that at the insured's death, the life insurance proceeds can flow directly into the trust and be held in trust for the benefit of its beneficiaries.

What are the benefits?

When properly established and managed, ILITs ensure that life insurance proceeds aren't considered part of one's estate, helping minimize federal estate taxes. But to do this, it's important the policy not only be owned entirely by the trust, but that the insured relinquish all ownership.

Since the insurance proceeds can be held in trust for your spouse, another benefit of the ILIT is that the proceeds can't be taxed in your spouse's estate either.

### Understand illustrations and consequences

While the tax advantages of ILITs are clear, there are other issues to be reviewed. Many ILITs, especially those funded with universal life insurance policies purchased in the early 1990s, could be in trouble.

These policy owners may believe that the life insurance policies they purchased were permanent and the annual premiums never would change. This may not always be the case. Without knowing it, some policy owners and trustees may be about to face premium increases.

Policies that were designed to mature at a designated age of the insured, with a healthy cash value, could instead fail to reach maturity at all because of recent declines in interest rates. These older policies often were purchased based on illustrated crediting rates of 8, 10 and even 12 percent.

These illustrations made the assumption that the life insurance policies would continue to perform at these crediting rate levels, but often the illustrated rates were overly aggressive.

In recent years, interest-rate declines have hurt the cash values of many of these types of policies compared to how they were originally illustrated to perform.

Policy owners and trustees may be unaware that their life insurance policies aren't

performing anywhere close to the way they were originally illustrated, and that some policies could potentially lapse without a major cash investment or substantially higher premiums.

A lapsed policy means no death benefit, no cash value and no refund of any paid premiums.

### How to avoid policy lapses

Individuals can address potential dangers by regularly evaluating the financial condition of their life insurance policies. Policy owners and trustees should receive annual statements from their insurance companies showing the financial condition of the policies.

One solution that can help to address the **estate tax problem** — and possibly provide many additional benefits — is the irrevocable life insurance trust (ILIT). Because the ILIT actually owns the life insurance policy, the death-proceeds benefit can avoid estate tax exposure.

Although the statements can be complicated, read them carefully and contact the insurance company with questions. Compare the original illustration and the forecasted current cash value to what the statement shows as the cash value.

Since early detection of any problems with an insurance policy is important, stay on top of the insurance companies by requesting updated inforce illustrations at least every three years. Ask to see:

- An illustration that shows how long the policy will last based on current assumptions and the guaranteed assumptions if the current premium stays the same.
- How much more must be paid to maintain the current death benefit until the targeted age, along with illustrations based on a reduced death benefit.

Although monitoring may be necessary, ILITs can be excellent estate-planning tools.

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