



# IRREVOCABLE LIFE INSURANCE TRUSTS: SECURING YOUR LEGACY WITH TAX EFFICIENCY

Estate and legacy planning is a multifaceted process that safeguards your financial legacy and ensures your loved ones are taken care of after you're gone. Among the array of available tools, one stands out for its unique advantages and strategic importance: the Irrevocable Life Insurance Trust (ILIT).

In this article, we'll explore what an ILIT is, why it's a powerful tool for estate planning, and how it can help ensure a tax-efficient transfer of wealth.

## What is an Irrevocable Life Insurance Trust (ILIT)?

An ILIT is a trust created specifically to own life insurance policies. Once established, the ILIT becomes the owner and beneficiary of one or more life insurance policies, separating the life insurance policy from the insured's estate. This structure offers several distinct advantages, including tax savings and greater control over how life insurance proceeds are used.

## Key Benefits of an ILIT

- 1. Estate Tax Reduction:** Life insurance proceeds are typically included in the estate of the policyholder if they own the policy, potentially increasing the estate's tax liability. By transferring ownership of the life insurance policy to an ILIT, the proceeds are excluded from the estate, which can significantly reduce estate taxes, especially for estates above the federal exemption limits.
- 2. Income Tax-Free Proceeds:** One of the less commonly emphasized but equally valuable benefits of an ILIT is that life insurance proceeds paid to beneficiaries are generally free from federal income tax. This means that your loved ones receive the full benefit of the policy, without needing to worry about income taxes eroding the payout.
- 3. Premiums as Gifts:** When funding an ILIT, the premiums paid for the life insurance policy are considered taxable gifts to the beneficiaries of the trust. These gifts can be applied to your annual gift exclusion, which in 2024 allows for gifts of up to \$18,000 per beneficiary (\$36,000 for married couples) without triggering a gift tax return. If the premium payments exceed the annual exclusion, they can be applied toward your lifetime gift exemption, which is \$13.61 million in 2024.
  - Crummey Letters:** To take full advantage of the annual gift exclusion, many ILITs are structured with a "Crummey power," allowing the beneficiaries a temporary right to withdraw the gift (in this case, the premium payment) for a short period. This right qualifies the gift for the annual exclusion. The trustee must issue Crummey letters to beneficiaries, notifying them of their right to withdraw the contribution. Though typically, the beneficiaries do not exercise this right, it is a crucial step to ensure the premium payments qualify for the annual exclusion and do not reduce the lifetime exemption.
- 4. Asset Protection:** Assets held in an ILIT, including life insurance proceeds, are generally protected from creditors. This ensures that the funds intended for your beneficiaries are safeguarded from potential legal claims or financial difficulties your heirs may face.

5. **Control Over Distribution:** With an ILIT, you can specify how and when the life insurance proceeds are distributed to your beneficiaries. This can be particularly useful if your heirs are young or inexperienced with managing large sums of money. You can set conditions on the timing of distributions or structure the payouts over a period of time to ensure responsible use.

6. **Probate Avoidance:** Proceeds from life insurance policies owned by an ILIT bypass probate. This allows for a more immediate transfer of funds to cover expenses such as taxes, debts, and other estate-related costs.

7. **Liquidity for Estate Taxes:** An ILIT can be used to provide liquidity to pay estate taxes or other expenses without the need to sell other valuable or sentimental assets.

### When is an ILIT Most Beneficial?

An ILIT is particularly useful in the following situations:

- **High-Value Estates:** If the value of your estate exceeds the federal estate tax exemption (currently \$13.61 million per individual in 2024), an ILIT can help reduce the estate's taxable value.
- **Blended Families:** When you need to provide for a spouse from a previous marriage while ensuring that children from a current marriage receive the bulk of your estate, an ILIT can be structured to meet these complex family needs.
- **Asset Protection Concerns:** For individuals who want to shield life insurance proceeds from creditors, legal claims, or potential mismanagement by beneficiaries.
- **Estate Tax Liquidity:** If your estate consists largely of illiquid assets, such as real estate or a business, an ILIT can provide liquidity to pay estate taxes without forcing the sale of these assets.

### Important Considerations

- **Irrevocability:** Once an ILIT is established and funded with a life insurance policy, it cannot be modified. Ownership of the policy is relinquished, so the policyholder cannot make changes.
- **Trustee Selection:** The grantor cannot serve as trustee of the ILIT. It is crucial to select a trustworthy individual or institution to act as the trustee, managing the trust according to your wishes.
- **Premium Payments & Crummey Letters:** Ensure that your premium payments qualify for the annual gift exclusion by issuing Crummey letters to beneficiaries. Failure to do so could result in the premium payments being applied toward your lifetime gift exemption, potentially reducing the amount available for other gifts during your lifetime.
- **Professional Guidance:** Proper setup and ongoing management of an ILIT require specialized legal and tax expertise to ensure compliance with IRS regulations and to maximize the benefits.

An Irrevocable Life Insurance Trust offers a powerful tool for enhancing your estate planning, providing both estate tax and income tax benefits, asset protection, and control over your financial legacy. By including an ILIT as part of your comprehensive estate plan, you can ensure that your wealth is passed on efficiently and according to your wishes.

**At Life By Design Investment Advisory Services, we specialize in tailoring estate plans to meet the unique needs of our clients. Contact us today to learn how an ILIT can benefit your family and fit into your broader financial goals.**

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