Ivan & Daugustinis
ESTATE AND TAX ATTORNEYS

Michael J. Ivan, Jr. +^
Robert Daugustinis
Clayton T. Miller
Andrew M. Woods ^
Michael P. Tyson *^

Board Certified in Taxation +
LL.M. in Taxation ^
Of Counsel *

IRREVOCABLE LIFE INSURANCE TRUSTS

Ensuring Your Insurance is 100% Tax Free

Most people know there is no *income tax* liability for the payout of life insurance proceeds, but many do not realize that the face value of the death benefit is included in the calculation of federal *estate tax* liability. The Irrevocable Life Insurance Trust (ILIT) is an estate planning tool designed to reduce or even eliminate payment of federal estate tax upon death. The federal estate tax exemption stands at $12,060,000 per individual for 2022 (subject, however, to any retroactive tax law changes made by the Biden administration and congress). However, the legislation that created this large exemption is set to expire on December 31, 2025, with the exemption being cut in half. If your assets are in jeopardy of being subject to estate tax upon death, the use of an ILIT (or multiple ILITs) may be vital to your estate plan.

ILIT Basics

- ☐ An ILIT is an irrevocable trust that is created by an individual (the "grantor") who "funds" the ILIT with one or more life insurance policies during the grantor's lifetime.
- ☐ The ILIT will be the owner and beneficiary of the policies based on the grantor's life.
- ☐ The grantor appoints a trustee (who may be a spouse, child, or other relative) who manages the ILIT and will be responsible for ensuring premiums are paid and making distributions to the grantor's beneficiaries after death of the grantor.

ILIT Advantages

- ☐ **Avoid Estate Tax**. Since the ILIT is the owner of the life insurance policy, the death benefits from the policy will not be part of the grantor's taxable estate and therefore will not be subject to federal estate tax upon the grantor's death.
- ☐ **Convert Old Policies**. Ownership of current life insurance policies can be transferred to an ILIT. This allows a grantor to convert an asset that may be subject to federal estate tax into an asset that will not be subject to federal estate tax.
- ☐ **Avoid Gift Tax**. If the ILIT is drafted and administered properly, the money used to pay policy premiums can qualify for the federal gift tax annual exclusion.
- ☐ **Dynasty Planning**. ILITs can also leverage a grantor's generation skipping transfer (GST) tax exemption. As a result, numerous generations may benefit from trust assets free of both federal estate and GST tax (see https://ivanlawgroup.com/blog/f/dynasty-trusts).
- ☐ **Asset Protection**. With proper drafting, assets left in an irrevocable trust for beneficiaries can be protected from their creditors.

ILIT Caveats

- ☐ **3-Year Rule**. If an existing policy owned by a grantor is transferred to an ILIT and the insured dies within three (3) years from the date of the transfer, the life insurance proceeds will be included in the grantor's taxable estate.
- ☐ **Gift Tax Issues**. The transfer of a life insurance policy into an ILIT will be considered a gift of the fair market value (approximately the cash surrender value) of the policy, and if that value is in excess of the annual exclusion, the Grantor's federal estate tax exemption will be reduced by that amount.
- ☐ **Inflexibility**. ILITs are irrevocable by design and a grantor's ability to make changes may be limited after the creation and funding of an ILIT.