

## Life Insurance Trusts

A life insurance trust (“ILIT”) is an irrevocable trust which is both the owner and beneficiary of one or more life insurance policies. Upon the death of the insured, the Trustee invests the insurance proceeds and administers the ILIT for one or more beneficiaries. If the ILIT owns insurance on the life of a married person, the non-insured spouse and children are often beneficiaries of the insurance ILIT. If the ILIT owns second to die or survivorship insurance which only pays when both spouses are deceased, only the children would be beneficiaries of the ILIT.

If possible, the trustee of the ILIT should be the original applicant and owner of the insurance. If the insured transfers an existing policy to the ILIT, the transfer will remove the insurance proceeds from the insured’s taxable estate only if the insured survives the date of the transfer by not less than three years.

Customarily, the trustee of the ILIT is authorized, but not required, to either purchase assets from the insured’s estate or loan insurance proceeds to his or her estate. Since the trustee of the ILIT possesses all incidents of ownership in the insurance policy, the ILIT provides the insured’s estate with liquidity while shielding the insurance proceeds or assets purchased with the proceeds the proceeds from estate tax when the insured dies.

A third party other than the insured must serve as Trustee.

Generally, the insured provides the funds for the payment of premiums by making gifts to the ILIT. For gift tax purposes, gifts to the ILIT are treated as gifts to the beneficiaries.

IRC §2503(b) excludes from the definition of taxable gifts the first \$13,000 of present interest gifts made to each donee by a donor during the calendar year. A gift of a future interest in property will not qualify for the annual exclusion. The most common technique used to qualify a transfer to an ILIT as a present interest is a Crummey withdrawal power, named for Crummey v. Comm’r, 397 F2d 82 (9th Cir 1968). Such a right typically permits a beneficiary to withdraw property of a specified value whenever a contribution is made to the ILIT. Withdrawal rights are customarily noncumulative and will lapse if not exercised within the time limits set forth in the trust instrument. The power of withdrawal constitutes an unrestricted right to the immediate use or possession of the property subject to the power, and the donor is entitled to the gift tax present interest exclusion. The Service’s position is that the donee must receive reasonable notice of his or her withdrawal right. Crummey withdrawal powers may be given to both income and remainder beneficiaries of an irrevocable ILIT.

ILITs are frequently drafted to take advantage of the settlor's exemption from the generation-skipping transfer tax, and therefore shield the insurance proceeds or assets purchased with the proceeds from estate taxation at the death of the beneficiaries of the ILIT. The irrevocable ILIT is an extremely efficient means of leveraging the Settlor's generation-skipping transfer tax exemption.