Tax Saving Benefits of a Life Insurance Trust

Many people have Revocable Living Trusts. They allow for the management of assets during their incapacity, avoid the necessity of probate at death, and usually save money in the post-death administration process. However, some people have an additional specialized trust, an Irrevocable Life Insurance Trust or "ILIT."

What's an ILIT? It's a trust that is used to hold any type of life insurance policy on your life, including term, universal, or whole life. In other words, the Trust is the owner and beneficiary of the policy or policies on your life. The trust is irrevocable, which means that it cannot be changed or undone by you after you set it up. Because of the manner in which the ILIT is structured, the life insurance death benefit is not included as part of your estate that is subject to estate tax. Typically your spouse is the *Trustee* or manager of the Trust. Usually, your spouse and children would be the beneficiaries of the Trust. During your life, the Trustee could use any cash value in the policies for the benefit of the beneficiaries. After you are gone, the ILIT can provide the funds necessary for your family to put their financial lives back together. After both you and your spouse have passed, the Trust can continue to provide for your children as you see fit. If your children are too young, a trusted friend can be Trustee until your children are of a suitable age (chosen by you) to manage the assets themselves. The Trust can even be designed to protect your spouse and children from their creditors.

Is an ILIT right for me? Unless you plan on dying before January 1, 2011, there will be a federal estate tax on your entire estate to the extent it exceeds $1 million. Your estate may also be subject to state estate or inheritance tax. In calculating the value of your estate, the government includes everything you own, no matter where it is or what it is. It includes your house, car, jewelry, stocks and bonds, etc. It even includes the death benefit of any insurance on your life. Even though the life insurance may not have had much value while you were alive, the full death benefit would be included in calculating the value of your estate. For example, if you had a house worth $400,000, investments worth $200,000, a car worth $30,000, and a 401(k) with $370,000, that would add up to $1 million. If you died in 2011, you could pass that tax-free. However, if you also had a $1 million life insurance policy, your estate would have a total value of $2 million and it would incur estate taxes of $435,000.

By having your ILIT own any insurance policies on your life, they would not be included in calculating the value of your estate. In other words, your estate would avoid having to pay the $435,000 in estate taxes outlined in the situation above!

Your ILIT could even own policies on the life of *your spouse*. However, in that case, your spouse could not be a beneficiary or Trustee of your ILIT. In the alternative, your spouse could have his or her own ILIT with you and your children as the beneficiaries.

Remember, a normal revocable trust does not provide the advantages of an ILIT. Be sure to contact a qualified estate planning attorney, who focuses his or her practice in estate planning and who can help you decide if an ILIT is the right solution for you and your family.