Altshuler and Spiro
EST. 1959

9301 WILSHIRE BOULEVARD, SUITE 504
BEVERLY HILLS, CALIFORNIA 90210-5412
(310) 275-4475 – (323) 272-5339
FAX (310) 858-6763

Bruce J. Altshuler*
Randy M. Spiro

* a professional corporation

Leo Altshuler
(1919-1999)
James J. Brown
(1918- 1987)

# INSURANCE IN AN IRREVOCABLE TRUST FOR A SPOUSE IN A COMMUNITY PROPERTY STATE

**By Randy Spiro**

Life Insurance is subject to estate tax if the insured owns it. One way to avoid estate taxes is for an irrevocable trust for the benefit of the children of the insured to be the applicant, owner and beneficiary of the insurance policy. But, under this solution, the spouse of the insured gets no benefit from the insurance proceeds.

Suppose the insured is the grantor/creator of the insurance trust and that his wife is the beneficiary of the trust. If her rights to use the proceeds at his husband's death are limited by an ascertainable standard—health, education, support and maintenance—the insurance would not be included in the husband's estate because he had no rights in the insurance and it would not be includable in the wife's estate because of the restrictions on her rights.

But if the wife were the grantor of a portion of the trust, that portion would be includable in her estate because her rights would have been a <u>retained</u> use rather than ones given her by her husband. If community property money were used to make gifts to the trust (which in turn would be used by the trust to pay the insurance premiums) 50% of the trust would be includable in the wife's estate for estate tax purposes.

Lets say the wife takes the amount of the premiums from a joint account and agrees in writing to gift it to the husband as his separate property. The problem here is there is a step transaction: the wife didn't make a gift to the husband out of disinterestd generosity, but rather because she knew that he would use the "gift" to contribute to a trust for her benefit. The IRS would have an excellent case for including 50% of the trust in the wife's estate.

What if the couple tries again. This time they agree in writing that an account twice as big as the premium will be annually converted from community property to half the husband's separate property and half the wife's separate property. The converted amounts will then be titled in new accounts each one under one spouse's name only. The husband would use his account to make the gift to the trust and the wife would keep her account separate and would never use it for the husband's benefit. With this scenario, the husband has contributed only his separate property to the trust and the wife would not have a retained use, i.e., none of the trust will be included in her estate for estate tax purposes.

But who will monitor the above arrangment? Who will see to it that the doubled amount is deposited half and half into separate accounts? Who will see to it that only the husband's account is used for the gifts? Who will see to it that the wife doesn't use her account for the husband's benefit?

For the above reasons it may be preferable not to give the non-insured spouse rights in the irrevocable trust because the estate tax risk of including half in her estate by not following all the rules may outweight the benefits.