LEVERAGING INCOME AND TRANSFER TAX-FREE GROWTH COMBINING ILIT TRUSTS AND UNIVERSAL LIFE INSURANCE

There are few remaining Congressionally sanctioned tax shelters. One of them is the receipt of income tax free life insurance death benefits. (Internal Revenue Code §101.) Another involves parents making "annual exclusion" gifts to their children which are neither taxable for gift tax purposes nor do they utilize any of a taxpayers lifetime unified gift and estate tax credit. (Internal Revenue Code §2503(b).)

Gifts made during 2014 are limited to $14,000 per donor to any child or other donee, so jointly parents can transfer tax free $28,000 to each child. The combination of these two techniques provides a leveraging of tax benefits.

Establishing and funding an irrevocable life insurance trust (commonly known as an ILIT) with permanent life insurance provides the straight forward route to enjoy these tax benefits. While whole life policies remain an attractive form of permanent life insurance with which to fund your ILIT alternatively permanent insurance built on a universal life chassis provides greater design flexibility and generally more control over the financial performance of the income tax free growth of the trust corpus.

More specifically, indexed universal life insurance (IUL) offers potential for achieving cash value growth which is correlated with stock market indices, often the S&P 500 while eliminating decreases in value with stock market downturns by incorporating a reset. The policy grows when the market is moving up (subject to caps on annual growth rates) but does not decline in value during market corrections. In other words the policy captures market upside while being protected from downward moves in the market – a feature not available with variable life insurance policies.

Returning to the mechanics of gifting, parents working with their estate planning attorney and life insurance professional, design an IUL policy typically focused upon providing the largest death benefit which can pass income tax and estate tax free to their children for the lowest insurance premium payments.

Typically planning starts with planned annual premiums equal to the annual exclusion available, $28,000 in the above example. The trustee of the ILIT purchases individual or survivorship insurance one or both parents naming the trust as beneficiary. Annual compliance with the notice requirements under Crummy v. Commissioner (citation omitted) - a simple but important step - will ensure the annual gifts will satisfy the present interest requirements and thus be free of gift tax.

For those wanting to build greater policy values than those curtailed by the $14,000 per child/beneficiary limit, taxable gifts can be made in addition to annual exclusion gifts. In such case there will be no out-of-pocket gift tax due until each donor's lifetime unified credit (currently $ 5.34m) has been fully utilized. Alternatively, split-dollar techniques can be used to leverage cash value growth and maximize the death benefit.

The below table is provided only to illustrate the mechanics of potential growth of cash value and death benefit and, importantly, may or may not represent product/results currently available in the insurance marketplace.

The sales illustration should always be reviewed in connection with a contemplated policy. The table represents a survivorship universal life policy which, for simplicity sake, utilizes a fixed crediting rate. Husband in the illustration is 56 years old and his wife is 51 at the time the trust is funded and policy procured. Maximum annual exclusion gifts fund the annual $28,000 premium payments by the trustee for fifteen years. This policy provides a $1,200,000 death benefit guaranteed for 44 years at which time the insureds would be 99 and 94, respectively.

See Table Next Page.

Guaranteed and Nonguaranteed Values

Policy Year	EOY Age	Planned Premium	Guaranteed Policy Value	Guaranteed Net Surrender Value	Guaranteed Net Death Benefit	Policy Value	Net Surrender Value	Net Death Benefit
1	56-51	$28,000	$21,764	$7,205	$1,200,000	$22,523	$7,964	$1,200,000
2	57-52	$28,000	$44,454	$30,189	$1,200,000	$46,733	$32,468	$1,200,000
3	58-53	$28,000	$67,542	$53,576	$1,200,000	$72,164	$58,198	$1,200,000
4	59-54	$28,000	$91,024	$77,362	$1,200,000	$98,878	$85,216	$1,200,000
5	60-55	$28,000	$114,893	$101,542	$1,200,000	$126,939	$113,587	$1,200,000
6	61-56	$28,000	$139,558	$126,520	$1,200,000	$156,889	$143,850	$1,200,000
7	62-57	$28,000	$164,668	$151,949	$1,200,000	$188,441	$175,722	$1,200,000
8	63-58	$28,000	$190,204	$177,809	$1,200,000	$221,681	$209,286	$1,200,000
9	64-59	$28,000	$216,147	$204,079	$1,200,000	$256,697	$244,630	$1,200,000
10	65-60	$28,000	$242,476	$230,742	$1,200,000	$293,582	$281,847	$1,200,000
11	66-61	$28,000	$269,173	$257,774	$1,200,000	$332,433	$321,034	$1,200,000
12	67-62	$28,000	$296,214	$285,154	$1,200,000	$373,352	$362,292	$1,200,000
13	68-63	$28,000	$323,578	$312,859	$1,200,000	$416,447	$405,728	$1,200,000
14	69-64	$28,000	$351,240	$340,866	$1,200,000	$461,827	$451,452	$1,219,520
15	70-65	$28,000	$379,176	$369,149	$1,200,000	$509,588	$499,561	$1,321,312
16	71-66	$0	$380,887	$371,209	$1,200,000	$532,709	$523,031	$1,362,317
17	72-67	$0	$382,030	$374,567	$1,200,000	$556,980	$549,517	$1,405,346
18	73-68	$0	$382,447	$377,060	$1,200,000	$582,428	$577,041	$1,450,689
19	74-69	$0	$381,996	$378,545	$1,200,000	$609,077	$605,627	$1,498,462
20	75-70	$0	$380,516	$378,861	$1,200,000	$636,967	$635,311	$1,548,892
21	76-71	$0	$377,810	$377,810	$1,200,000	$666,116	$666,116	$1,602,201
22	77-72	$0	$373,629	$373,629	$1,200,000	$696,511	$696,511	$1,658,529
23	78-73	$0	$367,655	$367,655	$1,200,000	$728,131	$728,131	$1,718,196
24	79-74	$0	$359,517	$359,517	$1,200,000	$760,930	$760,930	$1,781,449
25	80-75	$0	$348,762	$348,762	$1,200,000	$794,820	$794,820	$1,848,669
26	81-76	$0	$334,889	$334,889	$1,200,000	$829,692	$829,692	$1,920,054
27	82-77	$0	$317,264	$317,264	$1,200,000	$865,266	$865,266	$1,995,351
28	83-78	$0	$295,230	$295,230	$1,200,000	$901,231	$901,231	$2,073,998
29	84-79	$0	$267,958	$267,958	$1,200,000	$937,182	$937,182	$2,156,335
30	85-80	$0	$234,444	$234,444	$1,200,000	$972,482	$972,482	$2,242,188
31	86-81	$0	$193,388	$193,388	$1,200,000	$1,006,118	$1,006,118	$2,331,659
32	87-82	$0	$142,594	$142,594	$1,200,000	$1,037,098	$1,037,098	$2,425,105
33	88-83	$0	$79,763	$79,763	$1,200,000	$1,063,957	$1,063,957	$2,502,959
34	89-84	$0	$2,626	$2,626	$1,200,000	$1,086,160	$1,086,160	$2,498,710
35	90-85	$0	$0	$0	$1,200,000	$1,148,900	$1,148,900	$2,588,614
36	91-86	$0	$0	$0	$1,200,000	$1,216,803	$1,216,803	$2,681,786
37	92-87	$0	$0	$0	$1,200,000	$1,287,955	$1,287,955	$2,775,024
38	93-88	$0	$0	$0	$1,200,000	$1,362,854	$1,362,854	$2,868,987
39	94-89	$0	$0	$0	$1,200,000	$1,441,972	$1,441,972	$2,962,483
40	95-90	$0	$0	$0	$1,200,000	$1,525,951	$1,525,951	$3,054,188
41	96-91	$0	$0	$0	$1,200,000	$1,616,034	$1,616,034	$3,142,741
42	97-92	$0	$0	$0	$1,200,000	$1,714,086	$1,714,086	$3,226,155
43	98-93	$0	$0	$0	$1,200,000	$1,822,752	$1,822,752	$3,305,110
44	99-94	$0	$0	$0	$1,200,000	$1,944,774	$1,944,774	$3,377,009
45	100-95	$0	$0	$0	$0	$2,074,971	$2,074,971	$3,422,126
46	101-96	$0	$0	$0	$0	$2,213,892	$2,213,892	$3,428,233
47	102-97	$0	$0	$0	$0	$2,362,120	$2,362,120	$3,382,458
48	103-98	$0	$0	$0	$0	$2,520,279	$2,520,279	$3,271,032
49	104-99	$0	$0	$0	$0	$2,689,036	$2,689,036	$3,103,141
50	105-100	$0	$0	$0	$0	$2,869,099	$2,869,099	$2,872,827

Suitability of an ILIT and the policy used to fund the trust must first be assessed by advising professionals before incorporating the above strategy. Because the above strategy yields both income tax and estate tax savings, those exposed to both of these tax bases will enjoy the greatest benefit. That said, even those with estates which fall below the value threshold for taxable estates can benefit from income tax free access by the trustee to cash value as well as the non-taxable death benefit. Moreover, by their nature, ILITS provide an excellent asset protection both to the trust settlor parents but also the children as trust beneficiaries if the trust incorporates the proper protective provisions.