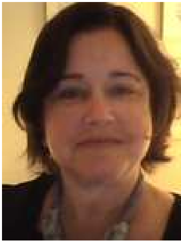
Alternatives for Life Insurance in Estate Planning



Written by: Robin Gorenberg

ALTERNATIVES FOR LIFE INSURANCE IN ESTATE PLANNING

Many people are not aware that the value of life insurance is includable in the estate of the insured as an asset for estate tax purposes (federal estate taxes and also state estate taxes depending on the state in which you reside). While naming the spouse as beneficiary eliminates the estate tax upon the death of the insured (due to the 100% "marital deduction"), estate taxes will be due if both spouses die together. In addition, if the surviving spouse does not exhaust the proceeds during his or her lifetime, then the unused proceeds would be taxed in the survivor's estate.

You may have consulted with an attorney, CPA, or financial planner who has advised you to have someone else (such as your spouse, or an irrevocable trust) be the owner of your insurance to exclude the insurance from your taxable estate. The following is a brief overview of your options. Please consult with an expert before completing any transfer of insurance or setting up any trust to be the owner.

Three parties to insurance:

Insured: person whose life is insured.

Owner (typically the insured): the owner is the person who pays the premiums, and who has the rights of ownership, such as the ability to change beneficiaries, or to borrow against the policy.

Beneficiary: person who gets the proceeds upon the death of the insured.

HOW TO EXCLUDE INSURANCE FROM YOUR TAXABLE ESTATE

A. Option 1 - Irrevocable Life Insurance Trust ("ILIT") as owner & beneficiary of your policies. *For married couples or individuals*

If you have a substantial amount of life insurance (and the value of all of your assets, including the insurance, is over the taxable level for federal ($5 million) and/or MA ($1 million) estate tax purposes, the irrevocable trust would be a good option to consider. *This type of trust would be set up to exclude the amount of the insurance from estate taxes*. However, the trust is irrevocable and comes with certain requirements and paperwork - careful consideration should be given to the pros/cons of such a setup.

Please note that you must survive **3 years** from the date you transfer existing insurance into this Trust in order for the insurance to escape estate taxes at your death. HOWEVER, if you are purchasing new insurance, you should have the Irrevocable Trust in place **before the purchase**, and have the Irrevocable Trust be the 1st owner of the policy - this avoids the 3 year survival requirement, and the insurance would immediately be non-taxable in your estate.

How it works: The Irrevocable Trust would be the owner of the insurance policy and also the beneficiary (for the benefit of your spouse and/or children). Although the proceeds would be held in this Irrevocable Trust, the surviving spouse would have the use of the money during his or her lifetime. At the surviving spouse's death, the trust assets would go outright to your children (or continue to be held in Trust until the children reach certain specified ages, if this is more desirable for you), or pass to any other beneficiaries you wish to name.

Requirements: The irrevocable trust, with all its estate tax benefits, has certain requirements which must be met in order to succeed at excluding the insurance from your estate, as follows:

- Obtain a separate tax i.d. number for the trust

- Open up a separate bank account for the trust, out of whichpremiums would be paid

- File simple annual federal and MA income tax returns (usually no tax due)

- Notify the beneficiaries of their rights under the trust (usually done once,at the onset, called a "Crummey notice")

- Fill out the necessary forms to change the owner and beneficiary of the policies

B. Option 2 - Naming your Revocable Trust (set up for estate tax savings) as *first* beneficiary of your insurance policy(s).

If you are married and have a taxable estate (greater than $1 million), **including life insurance**, and you have set up 2 Revocable Trusts to reduce the MA and/or federal estate tax, you can name your separate Revocable Trust as **first** beneficiary of your insurance policies, to more adequately fund your trusts and maximize estate tax savings. This would mean that upon your death, your spouse would get the proceeds through your trust rather than outright (but your spouse could be the Trustee of this Trust).