

Irrevocable Life Insurance Trusts

While revocable trusts can be useful estate planning devices, substantial tax advantages are often possible when life insurance policies are held in an irrevocable insurance trust. An irrevocable life insurance trust can remove the proceeds from the estates of both the insured and the surviving spouse, while making the proceeds fully available to meet the needs of the surviving spouse and the needs of the insured's estate. Such trusts can also provide for professional money management, where appropriate, and can achieve all of these results with little or no gift tax cost.

An irrevocable life insurance trust may be either funded or unfunded. A funded trust contains assets other than life insurance policies, and these assets are often held to produce sufficient income to pay the insurance premiums. An unfunded trust contains only life insurance policies. The insured typically pays premiums on policies held by an unfunded life insurance trust, either by direct payments to the insurer or by annual gifts to the trustee in amounts sufficient for the trustee to pay the premiums.

The post mortem dispositive provisions of a life insurance trust are normally designed so as to make the proceeds available to the surviving spouse, while still preventing inclusion of the proceeds in the surviving spouse's estate. The trust may be a sprinkling trust, or it may provide virtually all of its benefits to the surviving spouse during his or her lifetime.

There are several distinct advantages in making life insurance gifts through an irrevocable trust rather than making them outright. By using a trust, the insured can provide professional management of the proceeds by a carefully selected trustee. If the donee is immature or is simply not used to managing large amounts of money, this may be the most critical advantage of an irrevocable life insurance trust.

Also, an irrevocable life insurance trust can remove the insurance proceeds from both the insured's and the surviving spouse's gross estates while making those proceeds largely available to the surviving spouse for his or her health, education, support, and maintenance or for buying assets from the insured's estate and thereby providing estate liquidity without aggravating the estate tax liability.

There are, however, a few disadvantages in making gifts of life insurance policies in trust rather than making them outright. One disadvantage is the legal fees required to prepare the trust agreement. Second, if the insured dies within three years of giving the policies to the trust, the policies can be included in the insured's gross estate under a special provision federal tax law. Finally, permanently transferring a life insurance policy to an irrevocable trust will result in some loss of flexibility and access to the policy's cash value.

As with revocable trusts, it is important to carefully review your particular circumstances with your estate planner before deciding whether an irrevocable life insurance trust is appropriate for you.