



Oppenheimer & Co. Inc.
Spencer Nurse
Managing Director - Investments
500 108th Ave. NE
Suite 2100
Bellevue, WA 98004
425-709-0540
800-531-3110
spencer.nurse@opco.com
<https://www.oppenheimer.com/spencernurse/>



Irrevocable Life Insurance Trust (ILIT)



One of the main reasons we buy life insurance is so that when we die, our loved ones will have enough money to pay off our remaining debts and final expenses. We also purchase life insurance to provide for our loved ones' future living expenses, at least for a while. That's why it may seem unfair that life insurance proceeds can be reduced by estate taxes. That's right — the general rule is that life insurance proceeds are subject to federal estate tax (and, depending on your state's laws, state estate tax as well). This means that as much as 40% (currently the highest estate tax rate) of your life insurance proceeds could be going to Uncle Sam instead of to your family as you intend. Fortunately, proper planning can help protect your family's financial security.

An ILIT is a trust primarily set up to hold one or more life insurance policies. The main purpose of an ILIT is to avoid federal estate tax. If the trust is drafted and funded properly, your loved ones should receive all of your life insurance proceeds, undiminished by estate tax.

The key is ownership

Generally, all the property you own at your death is subject to federal estate tax. The important point here is that estate tax is imposed only on property in which you have an ownership interest; so if you don't own your life insurance, the proceeds will generally avoid this tax. This begs the question: Who should own your life insurance instead? For many, the answer is an irrevocable life insurance trust, or ILIT (pronounced "eye-lit").

What is an ILIT?

An ILIT is a trust primarily set up to hold one or more life insurance policies. The main purpose of an ILIT is to avoid federal estate tax. If the trust is drafted and funded properly, your loved ones should receive all of your life insurance proceeds, undiminished by estate tax.

How an ILIT works

Because an ILIT is an irrevocable trust, it is considered a separate entity. If your life insurance policy is held by the ILIT, you don't own the policy — the trust does.

You name the ILIT as the beneficiary of your life insurance policy. (Your family will ultimately receive the proceeds because they will be the named beneficiaries of the ILIT.) This way, there is no danger that the proceeds will end up in your estate. This could happen, for example, if the named beneficiary of your policy was an individual who dies, and then you die before you have a chance to name another beneficiary.

Because you don't own the policy and your estate will not be the beneficiary of the proceeds, your life insurance will escape estate taxation.

Caution: *Because an ILIT must be irrevocable, once you sign the trust agreement, you can't change your mind; you can't end the trust or change its terms.*

Creating an ILIT

Your first step is to draft and execute an ILIT agreement. Because precise drafting is essential, you should hire an experienced attorney. Although you'll have to pay the attorney's fee, the potential estate tax savings should more than outweigh this cost.

Naming the trustee

The trustee is the person who is responsible for administering the trust. You should select the trustee carefully. Neither you nor your spouse should act as trustee, as this might result in the life insurance proceeds being drawn back into your estate. Select someone who can understand the purpose of the trust, and who is willing and able to perform the trustee's duties. A professional trustee, such as a bank or trust company, may be a good choice.

Funding an ILIT

An ILIT can be funded in one of two ways:

1. Transfer an existing policy — You can transfer your existing policy to the trust, but be forewarned that under federal tax rules, you'll have to wait three years for the ILIT to be effective. This means that if you die within three years of the transfer, the proceeds will be subject to estate tax. Your age

The gift and estate tax applicable exclusion amounts are unified. Any gift tax applicable exclusion amount you use reduces the amount of the estate tax applicable exclusion amount that will be available.

and health should be considered when deciding whether to take this risk.

2. Buy a new policy — To avoid the three-year rule explained above, you can have the trustee, on behalf of the trust, buy a new policy on your life. You can't make this purchase yourself; you must transfer money to the trust and let the trustee pay the initial premium. Then, as future annual premiums come due, you continue to make transfers to the trust, and the trustee continues to make the payments to the insurance company to keep the policy in force.

Gift tax consequences

Because an ILIT is irrevocable, any cash transfers you make to the trust are considered taxable gifts. However, if the trust is created and administered appropriately, transfers of \$15,000 (in 2020 and 2021) or less per trust beneficiary will be free from federal gift tax under the annual gift tax exclusion.

Additionally, each of us has a gift and estate tax applicable exclusion amount, so transfers that do not fall under the annual gift tax exclusion will be free from gift tax to the extent of your available applicable exclusion. The gift and estate tax applicable exclusion amount is equal to the basic exclusion amount of \$11,700,000 (in 2021, \$11,580,000 in 2020) plus any applicable deceased spousal unused exclusion amount. Both the annual exclusion and the basic exclusion amount are indexed for inflation and may change in future years.

Crummey withdrawal rights

Generally, a gift must be a present interest gift in order to qualify for the annual gift tax exclusion. Gifts made to an irrevocable trust, like an ILIT, are usually considered gifts of future interests and do not qualify for the exclusion unless they fall within an exception. One such exception is when the trust beneficiaries are given the right to demand, for a limited period of time, any amounts transferred to the trust. This is referred to as Crummey withdrawal rights or powers. To qualify your cash transfers to the ILIT for the annual gift tax exclusion, you must give the trust beneficiaries this right.

The trust beneficiaries must also be given actual written notice of their rights to withdraw whenever you transfer funds to the ILIT, and they must be given reasonable time to exercise their rights (30 to 60 days is typical). It's the duty of the trustee to provide notice to each beneficiary.

Of course, so as not to defeat the purpose of the trust, the trust beneficiaries should not actually exercise their Crummey withdrawal rights, but should let their rights lapse.

The key duties of an ILIT trustee include:

- *Opening and maintaining a trust checking account*
- *Obtaining a taxpayer identification number for the trust entity, if necessary*
- *Applying for and purchasing life insurance policies*
- *Accepting funds from the grantor*
- *Sending Crummey withdrawal notices*
- *Paying premiums to the insurance company*
- *Making investment decisions*
- *Filing tax returns, if necessary*
- *Claiming insurance proceeds at your death*
- *Distributing trust assets according to the terms of the trust*

This newsletter should not be construed as an offer to sell or the solicitation of an offer to buy any security. The information enclosed herewith has been obtained from outside sources and is not the product of Oppenheimer & Co. Inc. ("Oppenheimer") or its affiliates. Oppenheimer has not verified the information and does not guarantee its accuracy or completeness. Additional information is available upon request. Oppenheimer, nor any of its employees or affiliates, does not provide legal or tax advice. However, your Oppenheimer Financial Advisor will work with clients, their attorneys and their tax professionals to help ensure all of their needs are met and properly executed. Oppenheimer & Co. Inc. is a member of all principal exchanges and SIPC.