

## LIFE ADVANCED MARKETS

# Flexible estate planning strategies

## Irrevocable life insurance trusts

After working a lifetime to build a level of financial wealth, there is a little more work to do to make sure that your success benefits those you care most for and creates the impact you desire. While each family is unique and estate planning strategies will vary, some of the more common goals include the following:

- Minimize federal and state transfer taxes (estate, gift, and generation-skipping taxes)
- Protect property from potential creditors (judgment creditors, bankruptcy, divorce, etc.)
- Ensure assets and property end up in the right hands
- Avoid family strife/fighting over the estate
- Avoid mismanagement of the estate by heirs
- Avoid probate (minimize cost and time, retain privacy)
- Distribute the estate such that heirs receive an equitable share
- Provide support for a charitable organization



**The primary goal of estate planning strategies is to pass on the fruits of your labor to the apple(s) of your eye.**

**– David R. Foster, JD, Allianz Life Insurance Company of North America**

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## The irrevocable life insurance trust

Life insurance may play a key role in accomplishing many of the estate planning goals mentioned above. If an estate does not have sufficient liquid assets to pay taxes due upon death, life insurance, such as a fixed index universal life (FIUL) policy, may help to avoid the need to sell off family assets to pay these taxes. In addition, life insurance provides an asset (death proceeds in the form of cash<sup>1</sup>) that is easily managed, easily allocated among beneficiaries, avoids probate, and may provide a level of creditor protection.

The estate planning strategies of life insurance may be enhanced by having the policy owned by an irrevocable life insurance trust (ILIT). An ILIT is a separate entity designed to own the policy and receive the death benefits. The trustee is given control over the policy and will be responsible for carrying out the terms of the ILIT for the benefit of named beneficiaries (typically the insured's spouse, children, or other family member).

It is a flexible document in that the grantor (the individual who establishes and funds the trust), working with their attorney, tax advisor, and financial professional, may decide how the trust will operate during their lifetime and how trust income and property will be distributed after their death.

One issue with the insured directly owning the policy is that the death benefit will be included in their estate for estate tax purposes. When an ILIT owns the policy and it is designed and administered properly, the death benefits will be excluded from the insured's estate. The insured may gift (or loan) money to the trustee who will then use those funds to pay the premiums. A gift to the ILIT may escape the federal gift tax as well.

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## Adding flexibility

One unique aspect of estate planning strategies is that the date in which your plans will go into effect is typically unknown (i.e., your death). This presents a challenge considering tax laws are constantly changing, family dynamics may change, and your personal financial needs may change prior to your estate planning strategy being triggered. With this challenge in mind, it is important to build as much flexibility into your plan as possible. An ILIT may include a number of provisions that increase its flexibility, including the following:

- The trustee may be given the right to “swap” assets. For example, if the grantor would like to remove a life insurance policy from the ILIT, the trustee and grantor may agree to swap ownership of the policy back to the grantor in return for assets of equal value.
- The trustee may be given the right to loan money to the grantor.
- A beneficiary may be given a limited power of appointment which grants them the right to name the party to receive their interest in the trust after they pass away.
- A trust protector may be named. This is an individual or entity that is granted the right to make trust changes in order to ensure the grantor's wishes are carried out. Duties are spelled out in the trust and may be broad or limited. The trust protector may be given the power to modify the terms of a trust and address unforeseeable events, such as changes in tax laws or family dynamics.
- The ILIT may be terminated or modified based on state laws. A termination or modification may require the signatures of all beneficiaries, the grantor, and the trustee.
- In some states, the ILIT may be permitted to go through the process of decanting, which involves taking all the principal out of the existing ILIT and placing it in a new ILIT with provisions that are more suitable to the grantor's goals.

<sup>1</sup> The death benefit is generally income-tax-free when passed on to beneficiaries. This content is for general educational purposes only. It is not intended to provide fiduciary, tax, or legal advice and cannot be used to avoid tax penalties; nor is it intended to market, promote, or recommend any tax plan or arrangement. Allianz Life Insurance Company of North America, its affiliates, and their employees and representatives do not give legal or tax advice. Customers are encouraged to consult with their own legal, tax, and financial professionals for specific advice or product recommendations.

- The grantor and/or the beneficiaries may be given the right to change trustees. Pursuant to IRS Revenue Ruling 95-58, the right to remove the trustee does not cause estate tax inclusion as long as the new trustee is not a “related or subordinate party.”
- The trustee (or a trust protector) may be given the right to change trust situs (i.e., governing state law). This may be appropriate in order to take advantage of laws in different states that may be more beneficial.
- A spouse may be included as a beneficiary, and the trustee given the discretion to distribute income to the spouse (typically limited to distributions for health, education, maintenance, and support – which may be broadly defined).

## Considerations

Life insurance requires qualification through health and financial underwriting.

- Clients should consult with their tax advisor and attorney to discuss their specific situation.
- Even though the ILIT is a flexible document, it is irrevocable. As mentioned above, the ILIT may be terminated or modified, but a termination of the ILIT does not result in trust income or property reverting back to the grantor.
- Applying the annual gift tax exclusion (\$17,000 per donee in 2023) to the grantor’s contributions requires the beneficiary be granted a first right to withdrawal of the contribution for themselves. The trustee must deliver a notice to each beneficiary notifying them of this right.
- The insured should not be named trustee. This would cause the death benefit to be included in their estate.
- There are costs (e.g., legal fees, potential trustee fees, and costs associated with estate planning professionals) to establish and administer an ILIT.



**TALK TO YOUR** attorney, tax advisor, and financial professional to discuss whether an ILIT or potential FIUL solutions are right for you.

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