ESTATE PLANNING

Life insurance trusts

Protecting your legacy is an important estate planning goal. Estate taxes and creditors can threaten to deplete your wealth. If these are important considerations for you, you may be interested in a wealth preservation and protection strategy known as an Irrevocable Life Insurance Trust (ILIT).

What is it?

An ILIT is an irrevocable trust that goes beyond basic estate planning. While an ILIT can hold many different assets, it is primarily designed to hold life insurance. When structured properly, policy insurance proceeds pass free of both estate and income taxes and are shielded from many types of creditors.

Estate tax management

In 2026, up to $15 million, indexed annually for inflation, of wealth can be transferred at death federal estate tax-free. Further, with proper planning, a married couple can essentially double the amount to $30 million, plus inflation. However, wealthy individuals and families, and those concerned that future tax law may significantly lower the tax-free amount or raise the tax rate, are often looking for ways to maximize and protect wealth transfers.

Taxable estates are subject to a top federal estate tax rate of 40% under current law. Moreover, roughly one-quarter of states impose a separate estate tax which can impact even modest estates. A properly funded ILIT can help mitigate (or eliminate) the tax burden for estate tax planning strategies.

Creditor protection

ILITs are an excellent planning vehicle for creditor protection in many states. If you work in a high-risk profession or are otherwise concerned about creditors, an ILIT may be appropriate to help you manage risk. ILITs can also offer creditor protection for your beneficiaries who may have concerns of their own.

How does it work?

You and your estate planning attorney establish an ILIT that fits your needs. As the trust's creator, you are known as the "grantor." You appoint a trustee to manage trust assets and make distributions to beneficiaries. The ILIT will own and be the beneficiary of a life insurance policy (typically on your life). Each year, you give funds to the ILIT to pay policy premiums.

At the death of the insured, the trustee receives tax-free life insurance proceeds and manages or distributes the funds to beneficiaries according to the terms of the trust document.

Using an Irrevocable Life Insurance Trust

ILIT:

- Owner and beneficiary of life insurance policy
- Receives death benefit proceeds
- Can make loans to or buy assets from grantor's estate

Heirs:

- Receive death benefit proceeds free of estate and income taxes

The benefits

- Life insurance policy proceeds pass free of both estate and income taxes in a properly structured ILIT, making this a powerful wealth transfer technique for the benefit of your heirs.
- ILITs are a highly effective way to provide liquidity to your estate. The trustee can typically make loans to or buy assets from your estate, providing a mechanism for much-needed liquidity for estate settlement needs.
- ILITs can be structured with a lifetime payout for your beneficiaries. This can be a powerful alternative to the Stretch IRA, a common planning technique unavailable to many non-spouse beneficiaries such as children, grandchildren and unrelated individuals.
- The trust can be designed to delay distributions to beneficiaries who need assistance with asset management or who are concerned about creditors or divorce.
- The funds you gift to the trust each year to pay policy premiums can be structured to take advantage of annual gift tax exclusion amounts, making this a gift tax-free leveraging technique.

Additional considerations

- In most cases, you should not be the trustee of your own ILIT.
- ILITs are irrevocable and can be very difficult to change. However, the ILIT can be drafted with language to provide some flexibility. For example, the trust might give you the power to substitute assets of equivalent value at a later date.
- As a general rule, you will not have access to policy cash values for your own benefit. You can add your spouse as a trust beneficiary using a type of ILIT known as a Spousal Lifetime Access Trust (SLAT), unlocking access for the benefit of your spouse for limited purposes (typically health, education, maintenance and support).
- If you give an existing life insurance policy to your ILIT, the estate tax benefits are generally only realized if the insured outlives three years following the gift.
- Creditor protection varies by state. If creditor protection is a concern for you, consult your attorney to discuss your particular situation. As a general rule, it is best to create an ILIT well in advance of any potential creditor claims or lawsuits.
- Work closely with your attorney and tax professional to make sure you and your trustee have the appropriate documents and filings to maximize tax advantages of the ILIT.

You can learn more about ILITs by requesting our client guide, Preserve Your Estate for Your Beneficiaries (Form 2307LMP). Contact your financial professional today.

This material provides general information that is designed to be educational in nature and is not intended as specific tax or legal advice to any particular individual nor the law of any particular state. Please seek the advice of a qualified tax or legal professional for your specific situation.

If tax-free loans are taken and the policy lapses, a taxable event may occur. Withdrawals (partial surrenders) and loans from life insurance policies classified as modified endowment contracts may be subject to tax at the time the withdrawal or loan is taken and, if taken prior to age 59½, an additional 10% federal tax may apply. Withdrawals and loans reduce the death benefit and cash surrender value.

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