

# Can life insurance help your estate plan?

Consider a strategy that aims to provide flexibility and manage taxes.

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Ben Franklin said that in this world nothing is certain but death and taxes. Well, one product sits at the intersection of both—life insurance. It may not help you cheat death, but it may help manage taxes.

There are certain estate planning steps we should all take, including the creation of a will and a health care directive. But if you have enough wealth that you expect your estate to be taxed—at either the state or the federal level—you may want to consider more advanced strategies, including using life insurance in a trust.

Life insurance can help families provide funding to pay estate taxes and provide other benefits for protecting wealth. “You may want to look at an irrevocable life insurance trust (ILIT) as an advanced planning technique,” says Rodney Weaver, Estate Planning Specialist at Fidelity. “It’s a good way to provide a source of ready cash that can be used to pay estate taxes on illiquid assets, such as property or businesses, or to allow wealth to pass to your heirs outside your estate.”

## Providing flexibility to heirs

One of the main reasons people set up an ILIT is to help provide their heirs with flexibility in settling their estate. One difficulty heirs often face is a lack of cash to pay

### Irrevocable Life Insurance Trust



May provide cash for heirs to settle estate.



Death benefit is generally not considered taxable income by the IRS.



Choose an insurer with a strong rating.



It is a complex legal arrangement requiring properly drafted documentation.



Consult a legal advisor regarding your specific situation.

estate taxes. (The top federal estate tax rate for 2016 is 40%. Also, a number of states impose separate state inheritance and/or estate taxes.) As a result, heirs may be forced to sell real estate, stocks, or a family business to raise cash.

Aside from being an administrative headache to accomplish in the nine months before estate taxes are due, selling assets can present problems. Your heirs may want to keep the home, jewelry, or other assets you have passed on but they may be forced to sell them to raise cash. Or the timing could be inopportune—a slumping stock market or depressed real estate values could force the estate to liquidate assets at low values. Another hazard of a forced sale is the potential to trigger income with respect to a decedent—in essence, forcing your heirs to pay additional taxes in order to settle the estate tax bill.

A key advantage of an ILIT is that if the trust is set up and administered correctly, the assets owned by the ILIT will not be considered part of your estate for inheritance/estate tax purposes—meaning your heirs won't have to pay estate or inheritance taxes on the life insurance death benefits that are paid after your death.

While an ILIT can provide a number of potential tax advantages, creating one is not a decision to be entered into lightly. A trust is a complex legal arrangement whose creation requires professional assistance, and it is most effective when in place prior to buying the insurance. The trust is irrevocable and once it is set up, you cannot terminate it, make changes to it, or withdraw the assets.

### Estate tax strategies to consider

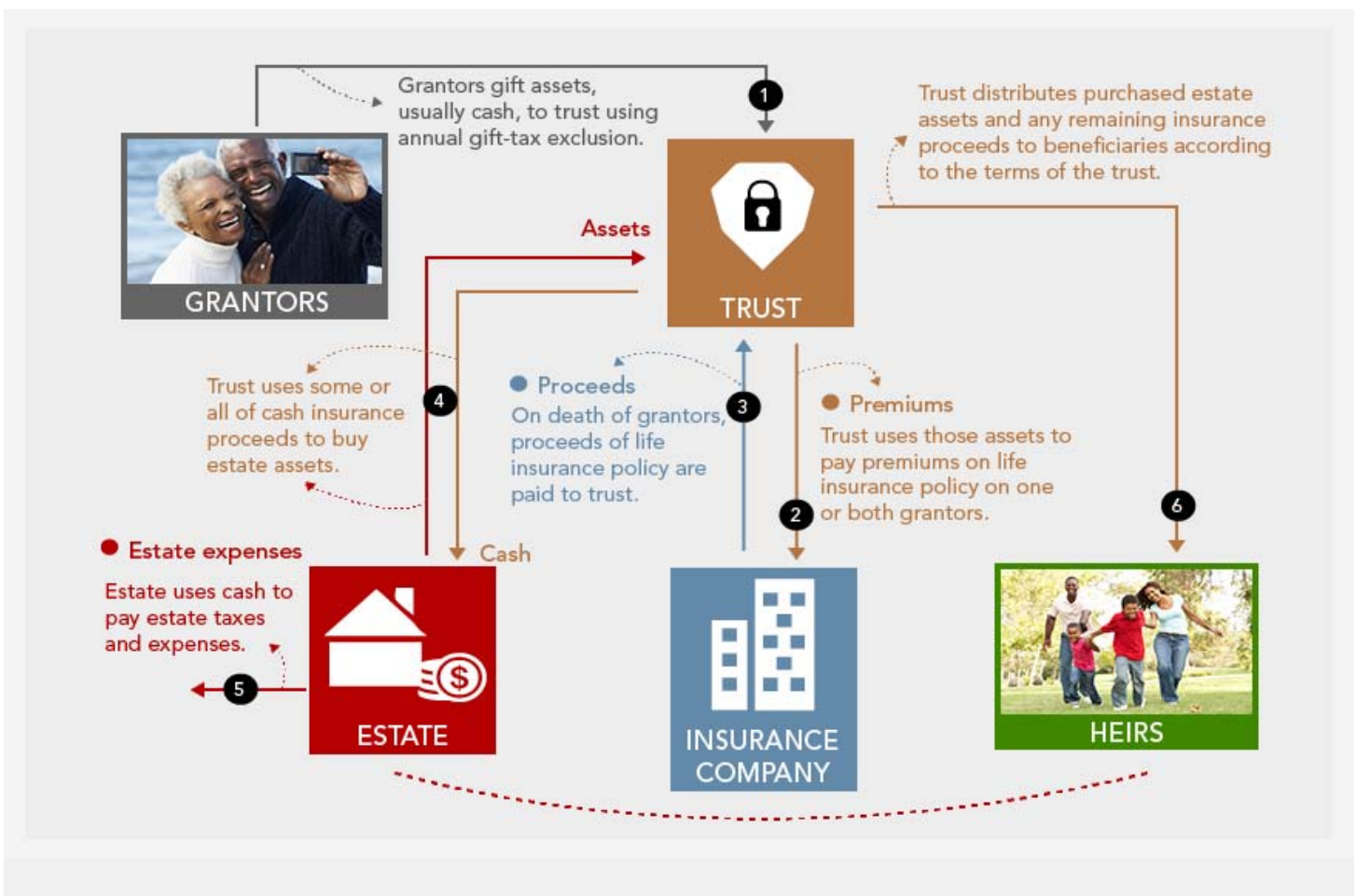
In 2016, the federal estate tax exclusion increased to \$5,450,000 per person or \$10,900,000 for a married couple that takes advantage of portability. There may be a lower state estate exemption amount in your state. As a result, you may have a state estate tax liability but not a federal estate tax liability. If your estate may owe state estate taxes, federal estate taxes, or both, it may make sense to consult your tax adviser or estate planning attorney about an ILIT.

## How an ILIT works

An ILIT is an irrevocable trust that purchases a life insurance policy on the person who set up the trust, called the “grantor.” If a couple sets up the trust jointly, the insurance policy purchased within the ILIT is usually a “survivorship” or second-to-die policy, so the death benefit won't be paid until the surviving spouse passes away.

When the grantor (or the surviving spouse) dies, the proceeds from the insurance policy flow into the ILIT and are eventually distributed to the trust beneficiaries, often the grantor's children, grandchildren, or other family members.

## One way to use life insurance in a trust as part of an estate plan



How the money in the trust is paid out to the beneficiaries depends on how the trust is structured. The beneficiaries might be able to access the money soon after the insured person’s death, or the trust assets could be paid out incrementally by the trustee over time.

## Making a gift count

Typically, premium payments for a policy owned by the ILIT are funded by gifts made by the grantor. To make sure that such gifts qualify for any available annual exclusions from the federal gift tax, beneficiaries of the ILIT are often given a short window of time after a gift is made—30 days is common—during which they may withdraw their share of the gift, up to the annual exclusion amount (in 2016, the annual exclusion amount is \$14,000 per beneficiary). Beneficiaries must understand the overall estate planning goals and not withdraw their gifts for this approach to be fully effective.

## Choosing insurance

For the life insurance within the ILIT, you can use term life insurance or a form of permanent insurance, including whole life or universal life. Many people choose permanent life, in part because the primary purpose of the ILIT is to transfer wealth to your heirs, which will only happen if the policy is still in force at the time of your death. If you outlive the term of your policy, the ILIT is essentially worthless.

“Term life is great for income replacement during your working years, but it’s generally not suitable for a permanent need such as estate planning,” says Tom Ewanich, vice president and actuary at Fidelity Investments Life Insurance Company.

Many companies won’t issue a term policy past a certain age, and most term policies do not extend beyond age 80. A universal or whole life policy, on the other hand, can provide coverage for a fixed annual cost for life.

Universal life policies are generally more flexible in design than whole life policies. For example, while whole life policies do provide a guaranteed death benefit, they also generally accumulate significant cash value that can be accessed during the insured's lifetime. But if your main goal is estate planning and you are focused on a guaranteed death benefit, then universal life may be the preferred choice, as those policies can often be designed to be less expensive than whole life.

Most ILITs are funded through the purchase of a new policy rather than through the gift of an existing policy. If an existing policy is gifted to the ILIT, the insured must survive for three years after the gift before the assets will be excluded from the insured's estate for estate tax purposes. In comparison, if funded through the purchase of a new policy, proceeds of the policy will not be subject to estate taxes in the insured's estate, even if the insured dies immediately after the ILIT's purchase.

The projected tax liability of the grantor's estate and the character of estate assets are the primary factors in deciding how much insurance to purchase. An ILIT provides the money to cover the taxes and gives the executor the flexibility to dispose of assets when it's most advantageous to the heirs. It can also be a means to transfer sums of money to a particular beneficiary. The ILIT itself does not directly pay the taxes, but, rather, it can lend money or purchase assets from the estate.

## Important considerations

**Strength of issuer.** "Because an ILIT could be in force for 20 years, 30 years, or even longer, it's vital for the grantor to have confidence that the issuer of the life insurance policy is a solid company and not likely to go out of business," says Robert H. Brown, a senior vice president at Fidelity Investments Life Insurance Company.

"The long-term nature of a life insurance contract means that customers should also be concerned about the longterm quality of the company issuing the policy," Brown says. "You may get a lower premium amount quote from one company or another, but remember that comparing companies' credit ratings is crucial. Try to balance both a lower premium amount quote and a high-quality company."

**The right trustee.** Choosing an experienced trustee is critical to administer the ILIT. Because of the crucial nature of paying premiums in a timely fashion to keep the policy in force, and handling details such as notifying beneficiaries when money is contributed to the trust, an experienced trustee is vital.

"From communicating with beneficiaries, to recordkeeping, to tax reporting, having the right trustee is imperative for a successful ILIT strategy," notes Weaver. "If you think you could benefit from an ILIT, talk to an estate planning attorney to explore the strategy in greater depth."

## Learn more

- Learn about Fidelity [estate planning and trust services](#).
- Contact your attorney or tax professional to discuss the potential benefits of an ILIT.
- Look into the [universal life insurance products](#) offered through Fidelity.
- Learn more by calling 877.204.8034 to speak with a Fidelity Life Insurance Consultant.

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