



Armor Trust Attorneys

Using Split-Dollar Insurance to Fund an ILIT

Irrevocable Life Insurance Trusts (ILITs) are a popular way to plan for estate tax liability. An ILIT is a trust that owns a life insurance policy on the life of the person who creates the Trust (the "Settlor"). If an ILIT is properly structured, the death benefits paid to the trust will be excluded from the taxable estate of the insured. In addition, the ILIT can also be structured so that the trust will provide benefits to the insured's surviving spouse without inclusion in the surviving spouse's taxable estate either.

An ILIT works as an estate planning technique because it utilizes the annual gift tax exclusion. Each year, a person may give away up to \$13,000 to an individual completely gift-tax free and may do so to as many individuals as the person wants. A married couple can give an individual a combined \$26,000 annually, gift-tax free. There is no limit to the total number of people to whom the couple may make gifts to. Another requirement for the gift tax exclusion is that the gift must give away a "present interest", that is, the recipient of the gift must have access to it immediately, not sometime in the future.

In most ILITs, the annual premium payment made to the ILIT is considered a gift to the life insurance policy beneficiaries. As long as the premium payments equal no more than \$13,000 per beneficiary or \$26,000 per beneficiary in the case of a couple, no gift taxes will be due. The Settlor gifts the premium to the ILIT and the Trustee obtains a Crummey Letter from each beneficiary waiving the right to receive their portion of the gifted amount as an immediate distribution from the ILIT. The Crummey Letter causes the gift to be a "present interest" gift not a "future interest" gift. As a result, if the Trustee receives a Crummey Letter from each of the beneficiaries, the premium payments to the ILIT will qualify for the gift tax annual exclusion.

What happens if the premium payment on the life insurance policy is more than the available annual gift tax exclusion? A family split dollar life insurance plan is an arrangement in

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which two parties enter into a contract to split the premiums and the benefits of a life insurance policy. Using a family split dollar arrangement with an ILIT can minimize or eliminate the gift tax resulting from the transfers into the ILIT. For example, Joe and Jane, both sixty-five (65) years old, have an estate worth \$10 million. They need insurance to provide cash to pay estate taxes and to provide liquidity for other purposes after their deaths. They predict that they will need about \$3 million in death benefits from the policy. Joe and Jane are already using some their gift tax annual exclusion to transfer assets to their children, so only a portion of the gift tax annual exclusion is available to apply to gifts to the ILIT. This is where split-dollar planning can be extremely beneficial to Joe and Jane. The ILIT can purchase a permanent second to die policy on the lives of Joe and Jane. Joe and Jane then can enter into a split-dollar contract with the ILIT agreeing that during their joint lives the trust will pay the portion of the premium equal to the insurance company's current premium rate for death benefit only term insurance. Joe and Jane agree to pay the balance of the premiums themselves, outside of the ILIT. Under the split-dollar arrangement, at the death of the surviving spouse (either Joe or Jane) the survivor's estate will receive back either the cash value of the policy or the total of the premiums paid by Joe and Jane, whichever is greater. The rest of the death benefit of the policy will remain in the ILIT to provide liquidity for the estate. The amount that remains in the ILIT is not includable in the taxable estate at the survivor's death.

In the example of Joe and Jane, the \$3 million worth of coverage will initially result in a relatively small premium payable by the ILIT. Over time the ILIT's premium cost will increase but will not increase suddenly as long as both Joe and Jane are alive. When the first spouse dies, the premium cost might increase dramatically depending. For this reason it is best to have an exit strategy from the split dollar arrangement planned in advance. The most common exit strategies involve using a Grantor Retained Annuity Trust (GRAT) or an installment note sale to an Intentionally Defective Grantor Trust (IDGT). These exit strategies usually are established at the same time as the split dollar arrangement and ILIT are established. They allow the death benefit of the ILIT to remain outside the taxable estate of the surviving spouse while at the

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same time providing the flexibility needed to plan for the rising premium costs of the insurance product at the death of the first spouse.

ILITs and split-dollar life insurance arrangements can be a very effective way to buy large amounts of life insurance coverage outside of one's taxable estate while making the most of the gift tax annual exclusion. ILITs and split-dollar arrangements must be carefully prepared and include exit strategies. If one of these techniques is something you believe will work for you, be sure to contact an experienced estate planning attorney before attempting to create them. Armor Trust Attorneys can help you design a split-dollar ILIT structure that will work for you.

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