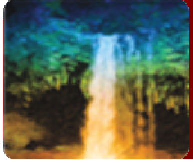


Estate Planning

"Revoking" an Irrevocable Life Insurance Trust

Life insurance owned by an irrevocable life insurance trust (ILIT) is a common estate planning strategy for high net worth individuals. The life insurance will be paid estate tax-free and income tax-free to the trust. The trustee can then use the insurance death benefit to purchase assets from the insured's estate, loan money to the estate, or retain the money for distribution to the trust beneficiaries who are usually the grantor's spouse and children. Over time, perhaps as a result of changing economic considerations, financial concerns, or tax law changes, the ILIT no longer seems like the appropriate solution. What happens then?

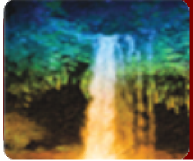
As time goes by, planning strategies that were implemented many years ago may no longer be the appropriate solution given current circumstances. For irrevocable life insurance trusts, there may be several reasons why that strategy may no longer be desirable, such as:

- You may no longer be concerned about estate taxes because of an increase in the estate tax exemption amount;
- Estate taxes may have been avoided by other planning strategies;
- Net worth may have declined due to market losses;
- Family relationships may have changed such that you no longer want one or more trust beneficiaries to receive trust distributions; or
- You want personal ownership of the policy for lifetime benefits.

Regardless of the reason, you may find yourself in a position needing to know what your options are, and whether or not you can collapse the trust and obtain personal ownership of the life insurance policy, or amend the trust to prevent a trust beneficiary from benefiting after your death.

The simple answer is it would be difficult to collapse the trust or amend the trust because the trustee will have a fiduciary obligation to protect trust property for the benefit of the trust beneficiaries; not you as the grantor. However, there may be some strategies to consider that might accomplish the same objective in an indirect fashion. Whether any of the following strategies can be used may depend on trust provisions and your local state law. Counsel, therefore, should be retained to assess your legal options before any action is taken.

1. You may be able to purchase the policy from the trustee for its fair market value. For example, suppose the trust policy has $100,000 of cash value. The trustee may be able to sell the policy back to you for $100,000, which could be cash or other property having the same value. The trust would then be funded with $100,000 of cash or property.
2. You may be able to create a new irrevocable trust (with the proper terms for your current situation) that may be able to purchase the policy from the existing trust so that the insurance remains outside of the taxable estate.
3. In some states, the trustee may have the ability to transfer trust assets to a new trust (known as "decanting" a trust), depending upon local law and trust provisions.
4. The trustee may have the right to distribute trust principal to one or more of the trust beneficiaries during the grantor's lifetime. So, if the trust distributes the policy to a beneficiary, perhaps your spouse or child, the beneficiary, in turn, could gift the policy back to you.
5. You can always stop paying premiums on the policy, or stop making gifts to the trust so that the trustee does not have funds to pay premiums. If the policy owned by the



trust is term insurance or a low cash value policy, the policy may lapse without additional premium payment. If the trust has no other property and the policy lapses, the trust terminates. However, depending upon the trust terms and local law, the trustee may have an obligation to exercise any policy rights that may continue coverage, such as extended term, or ask trust beneficiaries to make contributions.

In all situations, you and the trustee must be aware of potential consequences of removing a policy from an irrevocable trust. There may be gift tax consequences, liability issues, as well as insurability issues. For example, if you let the policy lapse because of non-payment of premium, you may be unable to obtain new insurance because of health issues, or the cost of new insurance may be higher than before because of age. If the trustee sells or distributes the policy while you are in bad health, and you die shortly thereafter, a trust beneficiary could have a cause of action against the trustee for violating a fiduciary duty. Even if you were in good health, a disgruntled beneficiary may attempt to make such a claim. To alleviate this concern, the trustee may want to obtain a waiver or hold harmless contract from each trust beneficiary before transferring the policy from the trust.

Before you consider terminating an ILIT or removing the insurance from the ILIT, make sure that you consult with your Guardian Financial Representative as well as your legal and tax advisors to ensure that this is the right course of action for you, and to minimize potential adverse consequences.

For more information on irrevocable life insurance trusts, or if you have questions on this document, please ask your Guardian Financial Representative for the informational memo titled: *Creating Liquidity to Pay Estate Taxes with an Irrevocable Life Insurance Trust*.

Lanny D. Levin, CLU, ChFC
LANNY D. LEVIN AGENCY, Inc.
1751 Lake Cook Road suite 350
Deerfield, IL 60015
(847) 597-2444
lanny_Levin@levinagency.com

The foregoing information regarding estate, charitable and/or business planning techniques is not intended to be tax, legal or investment advice and is provided for general educational purposes only. Neither Guardian, nor its subsidiaries, agents or employees provide tax or legal advice. You should consult with your tax and legal advisor regarding your individual situation.

GEAR # 2009-3933 Expiration: 12/31/2015

Guardian Financial Representatives may call the Business Resource Center for Advanced Markets, at 1.800.871.7780, Option 3, for additional information.

GUARDIAN® and the GUARDIAN G® Logo are registered service marks of The Guardian Life Insurance Company of America and are used with express permission.