Your Estate and Life Insurance

It All Adds Up

It can be fairly easy to underestimate your net worth. After all, predicting the future value of your home and savings is merely hypothetical. On the other hand, you can rely on the fixed amount of the **death benefit** provided by your **life insurance** policy. However, adding this often significant sum to your asset pool could expose your estate to the Federal **estate tax.**

Many people assume that, because death benefit proceeds from a life insurance policy are generally not considered taxable income to the beneficiary, a life insurance policy is out of the reach of the Internal Revenue Service (IRS). However, when the policy's death benefits are added to the appreciated value of your home and savings, the value of your estate may exceed the **applicable exclusion amount**.

Although the **unlimited marital deduction** allows spouses to transfer assets between one another free of estate taxes, nonspousal heirs face the possibility of seeing a life insurance policy bring an estate's value above the scheduled **exemption amount** in the year of death, which would increase estate taxes. Fortunately, there are **trusts** that can exclude life insurance from an estate.

Credit-Shelter Trust

One strategy to remove a life insurance policy from your estate is to use a type of **bypass trust** known as a **credit-shelter trust**. Essentially, a trust is an arrangement whereby one person holds legal title to an asset and manages it for the benefit of another.

For estate conservation purposes, a trust could be set up to maximize each spouse's applicable exclusion amount, perhaps sheltering more assets from estate taxation than may be possible through the use of the unlimited marital deduction alone. At the death of one spouse, an amount equal to his or her applicable exclusion amount could pass to a trust to benefit the surviving spouse, with the remainder of the assets passing outright to him or her. Then, at the death of the surviving spouse, assets in the credit-shelter trust could be paid to the couple's children—without being subject to Federal estate taxes. Any assets outside the trust upon the surviving spouse's death, and therefore potentially subject to the Federal estate tax, could be further sheltered by the surviving spouse's applicable exclusion amount for that year.

The ILIT Option

When children are the beneficiaries of a life insurance policy and the owner wants to exempt the policy from the estate's total worth, an **irrevocable life insurance trust (ILIT)** can be another approach.

However, the term *irrevocable* means policy beneficiaries may *not* be changed and loans may *not* be paid out from the policy once put into the trust. Including a high-value life insurance policy into such a trust could help beneficiaries finance the purchase of a family business or pay estate taxes. It is important to note that funding an ILIT may result in gift taxes due.

Depending on the type, trusts offer flexibility and may help to reduce or defer taxes on high-value assets such as a life insurance policy. In general, a trust can help ensure the policy's benefits go directly to the intended beneficiary. Be sure to consult with your tax and legal professionals to help determine your overall estate planning strategies.

EPLCOM02-X