Chuck Martino & Associates

Specialists in Business, Estate and Retirement Planning

About Life Insurance Trusts

QUESTIONS & ANSWERS

Q. ***What is an Irrevocable Life Insurance Trust?***

A. A Trust is an arrangement where a person or entity (Trustee) holds and manages property (corpus plus accumulated earnings) given by a person (Grantor or Trustor) for the benefit of another (Beneficiary).

Irrevocable (non-changeable) Life Insurance Trusts are often created to hold life insurance policies on the life of the grantor to help provide cash to the beneficiaries. The cash can be used to help pay taxes due at the death of the grantor. These taxes, called inheritance and estate taxes, may take more than 50% of a wealthy person's assets.

Q. ***Why does the Trust come into existence now? Why can't I wait until my spouse or I die to form the trust?***

A. The purpose behind the Trust is to save money in estate taxes as well as to insure that your wishes are carried out. Waiting until the death of you or your spouse to create the Trust will not avoid the heavy burden of estate taxation, nor will it guarantee that your wishes are being carried out because the intentions of the survivor of you and your spouse may well change.

Q. ***Why must the Trust be Irrevocable?***

A. If you were to create a Trust which would allow you to make changes as you saw fit during your lifetime, you would be in control of the assets in the Trust at the time of your death and all those assets, including the life insurance, would be included in your taxable estate.

Q. ***I thought life insurance was excluded from taxation?***

A. Life insurance proceeds are normally received **income** tax free, but the proceeds do not enjoy automatic exclusion from estate taxation. To avoid estate taxation, the insurance must be "removed" from the estate. This is often accomplished by having the trustee as owner and beneficiary of the policy.

Q. ***Is it necessary to create a trust to keep the proceeds out of my estate?***

A. No, you may often avoid the estate tax consequences by having your children apply for, own, and be beneficiaries of the policy. If you are satisfied that your children will do the 'right thing" with the policy and proceeds, then a trust may not be necessary.

Q. ***Am I obligating myself to continue to make premium payments because the trust is irrevocable?***

A. No! You are not obligating yourself to any premiums. Each premium payment is a separate and distinct voluntary act on your part and you may discontinue premium payments at anytime you choose. You should be aware, though, that discontinuing premium payments could cause the life insurance policy to lapse.

Q. ***Can the Trust be changed at a future date?***

A. No, it can not. To avoid estate taxation, the trust must truly be irrevocable. However, the trust may contain provisions allowing its termination by distributing its assets to the beneficiaries earlier than anticipated.

Q. ***What if my spouse and I were to legally separate or divorce?***

A. If a divorce or legal separation were to occur, the terms of the trust would continue. If some other result were desired, the attorney who is drafting the trust should be advised.
A clause may be put in the trust which provides that if at the time of death there is a divorce in effect, the beneficiaries of the Trust shall be changed.

Q. ***Can the trust provide unequal distribution of income or corpus to my children?***

A. Yes, the Trustee can be given discretionary power to distribute income and corpus to a class of beneficiaries that may consist of the donor's children. As an alternate, the Trustee can be required to make distribution in unequal portions to beneficiaries even to the exclusion of a family member.

Q. ***Who will make decision on options regarding the insurance policy that ordinarily are granted to the policyowner?***

A. All of these decisions will be made by the Trustee(s).

Q. ***Who should I select as Trustee(s)?***

A. The Trustee or Trustees are those people or entities (e.g. banks) that you choose to manage the affairs of the trust.
There are no limitations on who may be a Trustee other than choosing individuals or entities that are legally competent to act as trustees. In the case of an individual it must be an adult other than the insured(s). in the case of an institution, it must be an institution that enjoys the power to act as a trustee under the appropriate state regulations. A beneficiary may be a Trustee or a Co-Trustee.

Q. ***Should my trustee be notified in advance of their appointment?***

A. Yes, especially if you have decided to use a corporate trustee. Many commercial entities require specific language in the document before accepting an appointment as trustee.

Q. ***When my spouse and I are both deceased, must all of the sums be paid out immediately to my children?***

A. No. The death benefit proceeds that are available may continue to remain in trust for as long as you see fit, within certain reasonable limitations. It may be paid out immediately or over a period of years following the date of your death. You may even choose to have it paid to your beneficiaries upon the occurrence of an event such as reaching of certain ages, marriage, graduation from college, etc.

Q. ***Who makes the investment decisions on the Trust fund?***

A. These decisions are all made by the trustee(s) or you may leave instructions for the trustee(s) to hire professional investment managers.

Q. ***Are the trustees entitled to a fee?***

A. Trustees are entitled to charge and receive compensation which is usually referred to as "commissions"; commissions are often regulated by state laws and are generally calculated as a percentage of the total sum of money held in the trust. Some corporate (bank) trustees will have minimum fees in excess of these percentages. A trustee may also waive commissions.

Q. ***What type of investments may be properly made by a trust?***

A. Virtually any prudent investment may be made. If you are concerned with the latitude given to a trustee, you may restrict the trustee's choice of investments to narrow and as conservative a list as you deem appropriate.

Q. ***What if all of the money in the trust is needed to pay taxes when we are both deceased?***

A. This may be handled in one of two ways. First, an outright lump sum distribution may be made to your beneficiaries who, in turn, may use it to pay taxes. Second, the trust can be designed to "buy" assets from your estate, which has the effect of putting cash into your estate to pay the necessary taxes. the trust may not pay the estate taxes directly nor pay money to the estate without receiving property from the estate having equal value.

Q. ***May this trust be successfully attacked by my creditors?***

A. Generally, no; the main exception to this rule is if the trust were set up in an attempt to defraud existing creditors.

Q. ***May this trust be successfully attacked by the creditors of my children if they are in debt when my spouse and I pass on?***

A. When a trust is properly written, most states exempt the assets from the children's creditors so long as the assets remain in the trust. Creditors may recover the assets once they are distributed to the children.

Q. ***What filings are required in order for this Trust to be valid?***

A. No filing is required with the Internal Revenue Service other than the trust's annual tax returns. If the trust will have taxable income, a tax payer identification number will be necessary. This may be obtained by filing a form SS-4 with the Internal Revenue Service.
NOTE: Life insurance does not usually produce taxable income.

Q. ***Is this Trust a matter of public record like a will admitted to probate?***

A. No. One of the major advantages of the Irrevocable Trust is the privacy it affords to the individuals, which is not the case with one's will.

Q. ***May the Trust purchase additional life insurance policies other than the first one?***

A. When properly drafted, the Trust may purchase additional policies or receive other existing life insurance polices at any time in the future, subject only to the consent of the Trustees.

Q. ***May this Trust be used for assets other than life insurance policies***

A. Yes, your attorney can prepare the document to cover that possibility.

Q. ***May I make a separate provision in the trust for a "special" child?***

A. Yes. You may specify distribution to your children in any manner or proportion you choose. However, if provisions are being made for a "special" child, your trust must be carefully worded to avoid the loss of "entitlement" programs.

Q. ***May I use the same Trust to own single life policies and Last Survivor policies?***

A. Often, yes. It depends on what you want to accomplish. The use of the same trust for different policies depends on the wording of the trust and the designated beneficiaries and trustees.