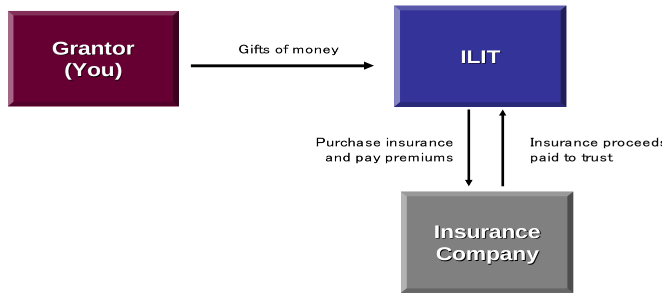
Creating Liquidity to Pay Estate Taxes with an Irrevocable Life Insurance Trust

Many business owners have significant net worth, but most of that net worth is tied up in their business. The business is, generally, an illiquid asset that cannot be quickly and easily sold. Nevertheless, upon death, the IRS requires that estate taxes be paid, in cash, within nine (9) months of death. That same dilemma applies to individuals who own a lot of real estate or other illiquid assets. What does that mean to your family when you pass away? Will your family have to use up whatever liquid assets you had (such as savings and investment accounts, which they may have expected to depend upon to continue their lifestyle needs) to pay the estate taxes and administration expenses owed, or will your family have to sell your illiquid assets at a discount at a "fire sale" to raise the money needed? Is there a better way to keep your family financially secure and to keep your financial legacy whole?

One Solution – Creating Liquidity Using an Irrevocable Life Insurance Trust

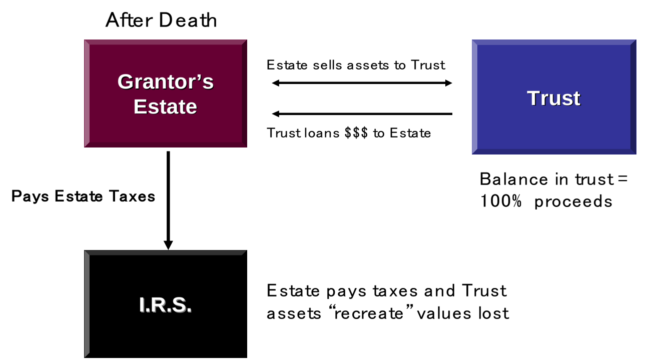
An irrevocable life insurance trust ("ILIT"), is an estate planning solution that anticipates the need for liquidity upon the death of a high net worth individual, to pay estate taxes and administration expenses, and to provide cash to surviving family members to continue their financial needs. An ILIT can also be used to replace the wealth that was lost to estate taxes and administration expenses. What's more, life insurance proceeds paid to the trust are free from income and estate taxes, and the trust protects the proceeds from the creditors of the beneficiaries of that trust (e.g., your children), and from their potential ex-spouses.

How Does it Work?



1. You work with an estate planning attorney to create the irrevocable life insurance trust (ILIT).
2. The ILIT is funded with money that you gift to the trust. The most common scenario is that gifts are made to qualify as a "present interest" gift through what are known as "Crummey withdrawal provisions." That means that the gift recipients (i.e., the trust beneficiaries) have an immediate right (usually lasting for a short period of time such as 30 days) to access the gift. The name Crummey comes from the name of a litigant in a court case that established the principle that when trust beneficiaries have the right to withdraw the money gifted to the trust, the gift will qualify as a "present interest" gift and when the gift falls within the annual gift exclusion amount ($14,000 per person for 2015), the gift is free of any gift taxes. The beneficiaries usually understand that they will ultimately receive more by not exercising their withdrawal right and leaving the gift inside the trust to purchase the life insurance.

3. The trustee of the trust then purchases life insurance on your life. (Depending upon how the trust is set up, the trust may purchase insurance on the joint lives of you and your spouse.) When you die, the trust receives the insurance proceeds from the life insurance company.



4. The trust now has cash to either make loans to your estate for the payment of estate taxes, or to purchase assets from your estate, converting illiquid assets to cash. The trust will now own your illiquid assets, such as your real estate or business. Note, that the trust does not actually pay the estate taxes on behalf of your estate, because doing so would cause the death proceeds to be includible in your estate. It only provides a liquidity source. Alternatively, the trust assets act as a replacement of any wealth that was lost due to the payment of estate taxes.

The end result is that a "fire sale" is avoided, and the trust will hold money or assets from your estate that are protected from creditors and can be used for the benefit of any of the trust beneficiaries. It also ensures that your financial legacy to your family remains whole, undiminished by estate taxes.

Please consult with your Guardian Financial Representative if you have any questions concerning this document.

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