Irrevocable Life Insurance Trusts

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There is a type of trust that protects your assets, helps with your estate planning, and helps minimize taxes. Unfortunately, it comes with a very big caveat. That caveat is that it is irrevocable. That means once you put assets into it, they are no longer yours and are governed by the rules of the trust. But there are times when you still might want to use it. Here's how it usually works:

You have substantial assets. You're 100% positive you're not going to need them to provide financial support for you during your life. You're worried creditors might get them and you're also concerned about exceeding the estate tax exemption ($5 Million under current law). So what you can do is put the assets into an irrevocable trust while you're still alive. Anything you put in the trust is protected from your creditors, because it isn't yours any more. Remember the gift tax laws allow you and your spouse to "gift" up to $13,000 a year each to anyone or anything you like without invoking "gift taxes" (a reduction in your $5 Million exemption). So the two of you can put a total of $26,000 a year into the irrevocable trust without reducing your exemption useable at death. If you do this every year for a decade or two before you die, you can substantially reduce the amount of your estate at death, perhaps even to the point where the estate won't owe estate taxes at your death.

Life insurance proceeds are income tax free. They are not, however, estate-tax free. If your estate is $4 Million and you also have a $2 Million life insurance policy, upon your death you'll owe estate taxes on $1 Million unless it is left to your spouse, which just delays the issue. One way to get around this issue is to put the policy inside the irrevocable trust. In fact, many people actually start a trust, then have the trust buy the policy on you. Since it is a policy that you want in force at the time of your death, not just for a specific period of time (term), you would buy a permanent life insurance policy, such as whole life. Now, whole life usually isn't a very good investment, but for the right person, it can have HUGE tax advantages with regards to the estate tax.

So what people do is buy as big of a whole life policy as they can buy for their age and health for a premium of up to $26,000 a year. They also often buy "second to die" type policies that only pay when the second spouse dies. This allows for a larger benefit and/or a lower premium to maximize the benefit. Upon the death of the second spouse, the trust receives the proceeds of the policy, which is then distributed to the heirs in accordance with the rules of the trust, free of both income tax and estate tax. Now, it sounds great to avoid all those taxes. But trusts, of course, have expenses, as do life insurance policies (especially permanent life insurance policies.) So this isn't a good idea for everyone, but it IS a great idea for those whose estates exceed the current estate tax exemption limit (currently $5 Million per spouse, or $10 Million total.)

One strategy is to use a credit shelter trust to get the full $10 Million exemption, then use gifts to an irrevocable life insurance trust to keep the estate under $10 Million. I don't anticipate ever having an estate bigger than $10 Million, but you might. Also, Congress might reduce the exemption amount at any time. It wasn't very long ago that the exemption was only $1 Million per person.

Learn more about estate planning [here](#).