ILIT: THE ULTIMATE TAX CUTTING POWER TOOL

Hate paying taxes? Want to ensure your family does not have to sell off your business, real estate, or the farm when you pass away to pay taxes? Do you have a plan? Today, we are going to discuss one of the best ways to avoid selling assets to pay Uncle Sam upon your death: The ILIT.

Let's start with one of the main culprits: Life Insurance. Life insurance is tax free, right? Wrong. While life insurance is income tax free, it is NOT estate tax free. The value of life insurance is included in your estate for estate tax purposes upon your death. This fact is shocking, especially when you consider that some taxable estates are only taxable because of life insurance policies. Imagine paying on a life insurance policy for 30 years only to have your loved ones retain just 60% of the value when you pass away. Although we see this happen every day, it can be easily avoided. Let's talk ILITs.

What is an ILIT?
An ILIT (Irrevocable Life Insurance Trust) is a type of irrevocable trust established specifically to own life insurance.

What type of life insurance goes into an ILIT?
You can transfer an existing life insurance policy to the trust or the trust can purchase a new policy on your life. You will generally use whole life or universal policies in an ILIT. Although, sometimes term policies are utilized depending on your goals and financial situation. The policy may be on your life, or if you are married, the policy may also be what is called a second to die policy.

Who controls the ILIT?
Not you. Although you can be your own trustee for your revocable trust, you cannot be the trustee of your ILIT. You cannot have any "incidents of ownership" or control over the trust or the policy. BUT…the good news is that your spouse can be the trustee. You get to choose your trustee when you set up the trust. While the trustee can be your spouse, it can also be an adult child, a trusted friend, your attorney, or a financial institution.

Is it better to just get rid of Life Insurance?
No. Life insurance may be an invaluable tool for you and your loved ones and is often a key component in your estate planning. You just have to be smart about HOW you are utilizing life insurance to ensure you are not causing an additional tax liability. Your life insurance agent does not know your estate planning goals and entire financial picture.

DID YOU KNOW?

Paying a 40% federal estate tax hurts. But, did you know that you may also have to pay a state estate or inheritance tax? While South Dakota does not have a state estate or inheritance tax, our neighbors in Minnesota, Iowa, and Nebraska do. Do you own property in any of these states?

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You need to work with your estate planning attorney to ensure you are using life insurance appropriately in your estate. If your attorney is like me, they will be sure to discuss your needs with your agent so everyone is on the same page and you receive the best possible outcome.

What is the benefit of an ILIT?
If you own your own life insurance policy and pass away, then the IRS will include the proceeds of the policy in the value of your estate, regardless of who is listed as the beneficiary. This makes your estate vulnerable to higher taxes and not just a small amount more…we are talking a roughly 40% tax rate. Let's say that there is a $1 million estate tax exemption when you pass away. You have a house worth $275,000, a few CDs for about $50,000 each, a sizeable IRA at $320,000, life insurance at $1 million, and $45,000 in your checking account.

TAX OWED WITHOUT AN ILIT: $316,000
TAX OWED WITH AN ILIT: $0

When you own your life insurance policy in an ILIT the death benefit is NOT included in your estate for estate tax purposes—this is what makes it one of the best tax cutting power tools in estate planning. ILITs also allow us to leverage the value of the policy outside of your taxable estate to provide liquidity to your beneficiaries when you pass to prevent the sale of assets such as a family business or a farm, if needed. But either way, it gives us the FLEXIBILITY we need to ensure your estate pays as little as $0 in estate taxes when you pass away. And before you ask, yes…it is legal and a tried and proved estate planning technique.

Who are the beneficiaries of the ILIT?
The trust itself is usually the owner and the beneficiary of the policy. When you pass, the proceeds are then paid to the trust and distributed or held pursuant to the terms of your trust. You get to select the ultimate beneficiaries and decide what protections they will need. Do you want the funds to be protected from a future divorce? Remarriage? Bankruptcy? Creditor issues? The ultimate design of how your beneficiaries inherit and what protections they have is up to you.

ILITS are still advanced planning trusts that should only be created by a qualified estate planning attorney who works with irrevocable trusts frequently. These are not fill in the blank documents. If you want to discuss if an ILIT is right for you or if you would like a second opinion on your ILIT, reach out today at 605-777-1772. One phone call could save your loved ones hundreds of thousands of dollars.

**This article is for general informational purposes and is not intended to give legal advice. Please consult with an attorney about your situation.*