



HOW TO START YOUR OWN BANK

(Using the Irrevocable Trust to Provide Estate Liquidity)

Although it can be a lengthy and highly technical document, the irrevocable insurance trust is a remarkably simple solution in concept. It's your own tax-free "bank" for paying estate taxes or meeting other cash needs. By executing such a trust, you will be saying, "I'm going to take this insurance, put it over here and lock it up." But you will not throw away the key. That's because. . .

I. The trust need not be *really* irrevocable. Things change. The law changes. Available insurance contracts change. So do beneficiaries. The facts which influence your decisions change. Therefore, a well-crafted irrevocable insurance trust gives someone the right to amend the document in response to changes. You are not required by law to give someone the right to amend the document, but if you do, your beneficiaries can avoid the traps associated with the traditional irrevocable trust.

II. Premium Payments and Related Paperwork. Premiums must be paid on life insurance policies in the trust. The law would treat these premium payments as taxable gifts by you to the trust beneficiaries -- unless you take specific steps to avoid this result. The method lawyers have developed to handle the problem is called a "Crummey" clause, named after a taxpayer who litigated the issue of taxability in a similar situation.

The idea behind the Crummey clause is that the trustee gives the beneficiaries an opportunity to withdraw from the trust the amounts you give to the trustee to pay the premiums. Despite what you've heard about \$13,000 "annual exclusion" gifts, current law actually limits each beneficiary's withdrawal right in most cases to \$5,000 annually, so premiums in excess of that amount per beneficiary will use up part of your \$2,000,000 applicable exclusion amount. (There are some practical ways to increase the \$5,000 limitation to \$13,000.)

In order to preserve the legal effect of the Crummey clause, you will want to transfer other assets to the trust in addition to insurance policies. A \$1,000 money market account in the name of the trustee may be sufficient.

III. Reduction of Estate Taxes. Except for making sure your generation-skipping transfer tax exemption is fully utilized, traditional revocable and testamentary trusts have very little impact on reducing your transfer taxes. They simply defer taxes until the second death. The irrevocable insurance trust, however, can be expected to save your estate as much as 45%

of the value of the insurance proceeds paid to the trustee (without taking state death taxes into account).

The reason for this dramatic result is that -- in a technical, tax sense -- you do not “own” the policies or their proceeds. Technical ownership is avoided through several restrictions on what you can do with trust assets. Those prohibitions are all part of the plan to keep you from owning the trust assets.

IV. The Blessing of Ownership without the Burdens. Under the usual rules of taxation, in order for an asset to be available to pay estate taxes, it must also be taxable. In this trust, you have the best of both worlds. This result is achieved largely because of the structure of the trust. This structure makes the cash available without making it taxable.

V. Administrative convenience down the road can be gained by permitting the trustee to consolidate this trust with any other trust for the same beneficiaries. Key provisions of the irrevocable trust should be made to “mesh” with any other trust you may have written for the same beneficiaries.

VI. Versatility. Also known as an “ILIT” (Irrevocable Life Insurance Trust) this trust can be used to avoid taxation on group term policies, split dollar policies and “wife” insurance, among others.

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