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Warning! Your ILIT Could Become Subject to Estate Tax

Death of the Irrevocable Life Insurance Trust (ILIT)

The proposed tax legislation in Washington includes a lurking surprise for many who have used an irrevocable life insurance trust (ILIT) to shift the death benefit of life insurance policies out of their taxable estates. These trusts, and the death benefit of the life insurance policy, may now be included in an insured's taxable estate at death.

How can this happen?! According to the bill, irrevocable grantor trusts created and funded after enactment, or portions of trust contributions made post-enactment, would be included in the grantor's estate at death. Most clients fund the ILIT by making annual gifts to the ILIT equal to the premiums for any life insurance owned by the ILIT. If the bill passes, future payment of premiums or gifts to pay the premiums will taint the irrevocable trust and cause some or all of the death benefit of the life insurance policy to be included in the grantor's taxable estate for estate tax purposes.

What Should ILIT Clients Be Doing?

Clients who have premium payments due between now and the end of the year should make those contributions as early as possible, and consider making additional gifts to prefund future premiums. This may require the use of some of the client's lifetime exemption.

Clients who cannot make substantial contributions now should be meeting with their estate planning attorney and life insurance agent to determine options for funding future premium payments. Options may include the following:

- Borrowing against the cash value to pay future premiums
- Obtaining a commercial loan to allow the insured to make a substantial gift to the ILIT
- Amending the trust to shut off grantor trust status before the date of enactment
- Evaluate split-dollar arrangements, premium financing, and other leveraged premium payment options
- Gifting income producing property to the ILIT to pay future premiums

Additionally, clients that have existing split-dollar agreements in which they file an annual gift tax return tracking economic benefit gifts or forgone interest payments should meet with their advisors to evaluate whether the split-dollar agreement should be modified or terminated since future gifts will taint some or all of the ILIT.

If you have questions about this Alert, to discuss any of these techniques in detail, or how these recommendations apply to a particular circumstance, please call Dan Peare, Hugh Gill, or Ryan Farley at 316.631.3131.

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