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THE IRREVOCABLE LIFE INSURANCE TRUST

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A very effective tool for dealing with the federal estate tax is the Irrevocable Life Insurance Trust. This type of Trust is fundamentally different from a Revocable Living Trust. Because it is irrevocable, an Irrevocable Life Insurance Trust cannot be changed or revoked even while you are living. However, as a result, any assets transferred by you to the Irrevocable Trust are effectively removed from your taxable Estate.

An Irrevocable Life Insurance Trust is usually funded with a single asset. Often that asset is a "permanent" (whole life or universal life) life insurance policy, where the premiums are paid over a period of 7-15 years. Upon your death, the insurance proceeds are exempt from federal estate tax because the proceeds are not included in your taxable estate. However, the Trust will permit the proceeds to be used to pay the federal estate tax liability incurred by your estate.

EXAMPLE: John and Sara's estate has grown to \$8,000,000. They can effectively shield and transfer up to \$7,000,000 (in 2009) of that estate to their children by utilizing a Credit Shelter Trust. However, \$1,000,000 of their estate will still "exposed" to federal estate tax, and will suffer a federal estate tax liability of approximately \$400,000. John and Sara set up a joint Irrevocable Life Insurance Trust, specifying that the trustee will buy a \$500,000 policy on the joint lives of John and Sara. (Joint life policies tend to be considerably less expensive than a life insurance policy insuring the life of one person.) John and Sara contribute \$5,000 each year for ten years to the Trust, which the trustee uses to pay the premium for the joint life insurance policy. (Normally the trustee of the Trust will be an independent third party.) If the Trust is properly set up, contributions to it will not constitute taxable gifts. Upon the death of John and Sara, the \$400,000 federal estate tax liability will be paid by the Trust, and any remaining proceeds will pass tax-free to John and Sara's children.

Generally speaking, by using this technique, the federal estate tax that would otherwise be payable can be discounted by up to 90%. That is, the total premiums paid may equal only 10% of the life insurance proceeds ultimately payable.

Note that normally a new life insurance policy is purchased by the Trust after the creation of the Trust. If you desire to place an existing life insurance policy in the Trust, you must live three years after setting up the Trust for the proceeds to be excluded from your taxable estate.

Please call or email us if you are interested in discussing this powerful estate planning tool.