MCF Private Trust

Creating and Reviewing ILITs

The irrevocable life insurance trust (ILIT) has been a useful estate planning tool for several generations. However, given the constantly changing tax environment and the developments in both estate planning techniques and insurance products, it is important to periodically review your client's ILIT to confirm that the rationale for creating the trust is still valid, that the trust as written still meets the needs and expectations of the client, and that the underlying insurance policy is performing in the manner contemplated at purchase. New clients may also have a need for an ILIT that needs to be discussed fully prior to the drafting of the instrument and purchase of the life insurance product. Here are some thoughts to consider in conducting such a review.

Much discussion has surrounded the new estate tax exclusions, eliminating the estate tax for the majority of Americans. While providing for liquidity to pay estate taxes without having to liquidate other assets was one of the principal reasons for estate planners to recommend creation of an ILIT, your client may now feel that the need no longer exists as, under the current law, they don't have a taxable estate. It might be wise to remind the client that tax laws can be changed by Congress whenever they feel the need, and that five years from now we could have a completely different tax code. Obviously, once a policy funding an ILIT is allowed to lapse, it cannot be reinstated, and the client will have to purchase new insurance that will probably be more expensive due to their increased age and changes in their medical condition.

Estate tax liquidity is not the only reason for establishing an ILIT. Frequently, equalization of inheritances among children due to the transfer of a family business to one or more of the children could be addressed by the liquidity provided by the trust. Periodic reviews of the client situation (sale of the business or change of heart of the children) may prompt a reexamination of the value of the ILIT to the client.

Major changes in a family situation frequently highlight that a review of an ILIT is necessary. A disabled beneficiary's receipt of government benefits may be jeopardized by an ILIT's lack of special needs

provisions. Because the trust is irrevocable, use of one of the progressive decanting statutes permits the insertion in the resulting trust of the protective language necessary to continue receipt of government benefits. The same is true if the client didn't initially consider creditor protection of the beneficiaries, divorce of the beneficiaries, or other problems of a beneficiary such as drug or alcohol abuse that could be mitigated or relieved by changes in the dispositive scheme of the trust through decanting. A jurisdiction's non-judicial and judicial modification statutes may also provide the intended result short of decanting the trust.

A periodic review of the life insurance company issuing the policy and the actual performance of the policy should also be conducted. The strength of an insurer should be assessed to confirm the company is delivering the right balance of low premiums and high credit ratings to give the client confidence that the company will be in business when the time comes for the payment of the death benefit. The insurance policy that forms the basis of the trust should be analyzed for performance, particularly in the case of universal life policies. The advisor should review the investment selection and the guaranteed, stated and actual performance of the policy, and, if underperforming, look into replacement with a new policy using a tax-free exchange, assuming the original policy is at least five years old.

The best way for the client to ensure that all of the legal and tax requirements of an ILIT are met is to use a professional trustee. The duties of an ILIT trustee include collection and remittance of insurance premiums in a timely manner, preparation and transmission of Crummey letters to beneficiaries and recordkeeping,