Irrevocable Life Insurance Trusts

Life insurance has an interesting history. While some current life insurance companies, such as New York Life and New England Mutual, trace their roots to the first half of the 19th Century, life insurance did not become widely available to working-class Americans until close to the turn of the 20th Century. Beginning in the 1880s, companies such as Metropolitan Life Insurance began selling life insurance through local agents, who collected weekly or monthly premium payments and stayed in close contact with their customers.

World War I gave the life insurance industry a jumpstart. All active-duty personnel were covered for death or disability and the government began selling low-cost life and disability insurance to active members of the military. After the war, mustered-out soldiers and sailors purchased life insurance from stock and mutual companies. By 1929, life insurance was so popular that the number of policies in force in the United States equaled total population.

Life insurance is still an important building block of family financial security, although not as prevalent as it was in the 20th Century. It has very interesting tax and creditor-protection advantages that should be considered in any financial plan. Irrevocable life insurance trusts (ILITs) are a way to harness these advantages to protect the financial security of our spouses, offspring, and other beneficiaries.

When the tax-free estate for federal estate tax was lower, ILITs were useful to bypass the taxable estate or to provide funds to pay the estate tax. Since the tax-free estate is now $5 million per individual, estate tax is a concern for only a small minority. However, ILITs can play a pivotal role in estate planning for beneficiaries who have disabilities.

A trust for a beneficiary who has special needs can be structured to provide an enhanced quality of life without diminishing public benefits, such as Supplemental Security Income or Medicaid. Using life insurance to fund this type of trust is cost-effective and avoids taxable income until after the death of the person whose life insurance funds the trust. For example, assume that an ILIT contains a $100,000 policy, on which the premiums totaled $50,000. On the death of the insured, the whole $100,000 is available for the beneficiary, tax-free. If the trust is properly structured, the trustee can distribute funds to improve the beneficiary’s quality of life, while the beneficiary continues to receive SSI, Medicaid, and other public benefits without reduction.

This type of trust has other applications, such as to benefit a son or daughter who has credit problems or a spouse who cannot be trusted. Garrison LawHouse, PC can help you set up an estate plan that will provide the greatest benefit for your heirs and other beneficiaries, while ensuring the manner in which your estate will be distributed will reflect your values and desires. Setting up an ILIT may be one of the ways to ensure that your objectives will be reached.

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