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NEW REASONS FOR INSURANCE TRUST

Years ago when the federal estate tax exemption amount was limited to \$600,000, it was common for a family of means to insure the lives of the parents, placing that insurance within an irrevocable life insurance trust (ILIT). The idea behind the trust was to exclude the insurance from the estate of the parents, while providing liquidity to pay estate taxes without the children having to sell off other assets such as homes, stocks, land and family businesses.

As the estate tax exemption amount has increased, it would appear that the need for insurance to fund any estate tax liability would have decreased as well. Notwithstanding the possibility that the federal estate tax exemption amount may decrease from its current amount of \$2 million back down to \$1 million in 2011 (about \$600,000 in inflated dollars since the law changed), and if the laws aren't changed between now and 2011 ILITs will become popular again, most practitioners believe that the federal estate tax exemption amount will land somewhere between \$3 and \$5 million.

Even if the estate tax is not a liquidity problem for most estates, there remain other reasons to retain that ILIT or to invest in life insurance to cover liquidity needs in the event of a loved one's death:

- Retirement accounts are becoming a larger portion of the average citizen's estate. Remember that retirement account balances are taxed to the recipient when withdrawn. This presents a double taxation problem. The assets are withdrawn to pay estate tax, but the withdrawal causes income tax. Moreover, the withdrawn money cannot continue to grow tax deferred within the plan. Even where the retirement accounts aren't subject to estate tax, they may be the basis for all the liquidity in the estate, putting pressure on the surviving spouse and heirs to consume the retirement accounts for living expenses, thereby losing the ability for continued tax deferred growth. In all these instances, it makes sense

to invest in a life insurance policy owned by an ILIT to cover these liquidity needs;

- Where there is a surviving spouse of a second marriage where the decedent had children from a prior marriage could be a good reason to purchase life insurance and hold it in an ILIT. Often it is not a good idea to "tie" the surviving spouse economically to the decedent's children for the rest of her life. By creating a marital trust that pays the surviving spouse the income (and principal invasion rights) for the surviving spouse's lifetime with the remainder to the decedent's children upon her death does just that. Instead, especially where the surviving spouse may not be that much older than the children from the first marriage, consider purchasing life insurance to give to the children, and make the bequests of homes, stocks and bonds outright to the spouse. This way, both the spouse and the children can get on with their lives and not be tied to one another;

- Where a majority of the estate is in illiquid assets such as real estate investments, business interests and home values. Here the surviving spouse may have a healthy balance sheet, but her liquidity needs may surpass the income that she receives, especially if her decedent spouse's pension is reduced or even eliminated entirely on his death. Often I see in my practice circumstances where the decedent thought that he was leaving his spouse a healthy retirement only to find that she doesn't have the liquidity necessary to support her lifestyle.

These are just a few reasons one might consider investing in life insurance within an ILIT. If you have questions as to whether this strategy might be right for you, consult with competent estate planning counsel.

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