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"REVOCABLE" LIFE INSURANCE TRUSTS

A Contemporary Strategy in a New Tax Landscape Under the TCJA

INTODUCTION

1. The cross-over between Life Insurance and Estate Planning has historically been confined to *Irrevocable* Life Insurance Trusts. **Under the new tax law**, capturing the **advantages of the ILITs without the disadvantages** provides many opportunities.
2. Even though life insurance can be paid into one's family trust (revocable living trust), there are significant advantages to carving out a **separate revocable trust** ("*Revocable* Life Insurance Trust").
3. Revocable Life Insurance Trusts can be very a **very powerful tool** adding a large multiple of benefits to standard (and existing) life insurance policies.

WHAT IS A "REVOCABLE" LIFE INSURANCE TRUST

4. <u>A Stand-Alone Revocable Trust</u>
    a. A stand-alone **revocable living trust** designed specifically for owning life insurance (or receiving death benefits) in order to accomplish certain objectives.
5. <u>Focused Primarily on Owning Life Insurance</u>
    a. Typically designed for and focused **solely on life insurance**.
6. <u>Maintains, and Adds to the Advantages of an ILIT</u>
    a. With the Unified Credit so high ($11.4M), there are **other advantages to holding life insurance in a trust** other than gross estate exclusion.

A VARIETY OF PURPOSES AND GOALS

1. <u>Allows for Complete Control of Distribution of Death Benefits</u>
    a. Trusts can be designed to pay out benefits over time or in phases **to minimize risk of misuse** by beneficiaries.
2. <u>Can Influence or Control Beneficiary Behavior</u>
    a. Distribution of benefits can be made contingent **based on certain behavior or accomplishments** (e.g., "bonus" for graduating, income matching, etc.).
3. <u>Provides Asset Protection for Beneficiaries</u>
    a. With the benefit being paid into a trust, the beneficiary can have a **substantial amount of control** while also receiving continual benefits.
4. <u>Allows for "Forum Shopping" or "Jurisdiction Shopping"</u>
    a. **Special jurisdictions can be used** for life insurance (e.g., Alaska for multi-generational longevity, Delaware for asset protection, etc.) while the insured's home jurisdiction can be used for the rest of the estate.

5. Can Also Act as a Pre-Funded Special Needs Trust
    a. Financial planning can reveal specific financial needs of fixed-income beneficiaries, and **life insurance paid into a SNT can pre-fund care**.
6. Provides Opportunity to Small Estates
    a. Small estates can avoid probate even without a trust, but a Revocable Life Insurance Trust can **provide control of distribution even though probate avoidance is not needed**.
7. Equalization of Multiple Variable Policies
    a. Multiple policies exposed to varying investments and levels of risk can be **grouped within a single trust, thus equalizing distribution**.
8. Can Act as a "Trial Run" for any Estate Plan
    a. Current trustees can be put in place while the Settlor still maintains the right to step in him/herself. A situation can be created where **the Settlor is able to see how trustees and beneficiaries will interact with each other**.
9. Creates Intra-Family Privacy
    a. A policy paid out to a separate trust will be 100% confidential to everyone but the beneficiary/ies of that trust, **allowing for unequal distributions among family members** (if needed).

REVOCABLE v. IRREVOCABLE LIFE INSURANCE TRUSTS

1. RLITs Have Certain Advantages over ILITs . . .
    a. They are **easy to control**, amend, and effective at managing multiple policies.
    b. They allow for protection of the policy even when the owner is **incapacitated**.
    c. They can be structured so as to have **zero tax implications**.
    d. They can receive, and **coordinate with other assets** (IRAs, etc.).
    e. They provide flexibility throughout life for **multi-generational planning**.
2. . . . However, RLITS do Have Some Disadvantages ILITs do Not
    a. Death benefits are **included in the grantor's gross estate**.
    b. Unlike an ILIT, there is a constant need to ensure the trust is **properly funded and treated as a "separate" entity**.

TAX IMPLICATIONS

1. Gross Estate Inclusion
2. Unlike an ILIT, the Payment of Premiums are Not Gifts
3. Policy Owned by one Party on the Life of a Second Party Paid to a Third Party Constitutes a Gift
4. All Income Tax Liability is Taxed to the Grantor

ASSET PROTECTION IMPLICATIONS

1. No Asset Protection for Grantor
2. Benefits Paid to Beneficiaries are Protected from Beneficiary Creditors
3. Beneficiaries Can Maintain Some Control and Still Enjoy Protection

CONCLUDING THOUGHTS

1. With the Unified Credit so high, let statute plan away the estate tax when possible and harness the advantages and power of revocable trusts to own life insurance.