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# "I No Longer Need This ILIT-Owned Policy – What Should I do?"

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The American Taxpayer Relief Act of 2012 was passed by Congress and signed by the President in January of 2013. For the first time in more than a decade certainty has been achieved in estate planning matters such as the Death Exclusion, Lifetime Gifting and Estate Tax rates. In the wake of this recent development, the insurance policy planning that has occurred for the last 20 years, now leaves clients and trustees with some new questions and difficult decisions. It is interesting to view this same issue from three different perspectives:

**The Client** - "I do not need this policy anymore and better yet I do not want to have to pay for it either. I wonder if I have access to irrevocable assets."

**The Insurance Agent** - "Ugh oh, I have made a career out of selling these policies, many rigid in their premium structure with the need for ongoing or lifetime premiums. What should I tell my clients?"

**The Trustee** (Non-Corporate) – "I really did not understand what I signed up for years ago and now I do not know what to do or where to begin to provide guidance for this valuable asset to the Grantor and their beneficiaries."

All three responses are realistic but consideration needs to be given to the real issue - the Trusts are irrevocable and past premiums have been made as gifts without access to the values. The Grantor's role in the situation is basically to make gifts, which may or may not include continual funding of premium payments. The terms of the trusts typically allow eventual death proceeds to pay taxes due and then provide access to funds for beneficiaries for HEMS (Health, Education, Medical and Support) typically for multiple generations. Moreover, when combining the structure of the policies with the Trust language, this often leaves all parties to the transaction confused and wishing for a simple linear solution.


*"When considering what to do with policies for estates valued less than $5MM, $10MM for married couples, does a simple solution exist?"*

It is certainly true that the irrevocable trust is a relatively inflexible agreement. Since 2001 there have been some efforts by good attorneys to make such agreements more flexible. Such things as "spousal access," trust protectors or special trustees, and broader discretionary trustee powers are examples of this attempt to gain flexibility. Some states have passed what is called a "decanting" statute, which allows the assets of an old ILIT to be transferred to a new one under certain circumstances (although the IRS has not weighed in on this issue). Some grantors and beneficiaries have more options than others. Still, an examination of the agreement is always a critical part of this analysis.

When considering what to do with policies for estates valued less than $5MM, $10MM for married couples, does a simple solution exist?

Attorneys will often recommend a fee-based TOLI or Trust Owned Life Insurance analysis. The clients will most likely favor options that seek to eliminate ongoing premiums. The insurance agent should consider both existing and alternative options available in the marketplace today.

Unless a comprehensive approach is taken that considers the legal, tax, financial and insurance policy components a short-term financial decision may conflict with the long-term generational and tax benefits designed at inception of the ILIT. All decisions can be deemed reasonable if filtered through a simple rule, "does it comply with the language in the ILIT and does it make good financial sense?" Remember, when the decision was made to purchase insurance for estate tax reasons, it was made after a careful analysis of cost and benefit, internal rates of return, net present value and how it compared to alternative investment strategies. The document was carefully drafted at its inception and was assumed to contain the most beneficial trust language at the time it was prepared. If it made sense then, it probably still makes sense today. This analysis should be conducted by a consultant adept at the four required disciplines - law, insurance, finance and tax.

The options for an existing insurance policy owned by an ILIT are the same as they always have been:

- Maintain current policy and continue to fund as recommended at inception or from latest in-force analysis.

- Consider reduced face amounts and cease premium payments.
- Surrender policy for net cash value. This option may have adverse income tax consequences if cash values are greater than cumulative premiums; determination of basis is difficult in the case with Whole Life contracts as the various dividend options are not always apparent.
- Exchange policy for like values from estate and use for alternative purposes such as charity or key person - especially if health has changed.
- Update insurance contract with products issued today with more favorable pricing and features.

A comprehensive approach to determine what to do with an ILIT-owned life insurance policy should include the following:

- A preliminary insurability review of health. If the insured's health has changed and mortality reduced, the death benefit has an increased chance of paying off sooner than when originally issued. Additionally, the insured may not be able to obtain new insurance at competitive rates, which enhances the value of the existing policy.
- An estate analysis to determine amounts and needs, if any. Additional costs at death might include state death taxes, IRD (Income in Respect of a Decedent), future tax law changes, etc.
- A document review of the ILIT language to understand the options available for the trust assets.
- A policy review to determine the inherent values, options available - there are many unknown components that exist in a policy that may differ from the declared cash and surrender values.

The existing planning and ILIT insurance benefits are, and continue to be, very valuable assets for the clients and their beneficiaries even in light of the changing tax law landscape.

Those who control the destiny of these assets include the Grantor and whether they continue to fund the initial program, the Trustee and their fiduciary responsibilities to act in a prudent and 'dispute defensible' manner on behalf of the beneficiaries and the benefactors of the planning who hopefully agree on the path of decisions made on their behalf.

*Expect A Comprehensive Analysis To Take 60 to 90 Days.*

More than likely, these decisions will be made in calendar year 2014. Normally, the discussion will spawn from premium notices that are typically sent to the trustees two to three weeks prior to the policy anniversary and premium due date. Two to three weeks is not sufficient time to determine prudent paths and options. It is recommended that the premiums be paid on schedule this year and that the consultative analysis be conducted soon thereafter. All components of a comprehensive study can take 60 to 90 days.

In summary, consider the original intent of the planning, the financial decision to purchase the insurance, the tax-free nature of the death benefit, the same metrics that made it a decision worth acting on initially, and all the possible outcomes that are produced from a comprehensive analysis. When the insurance is viewed as a financial asset that can benefit future generations, and not as a cost item, then all parties can usually agree on the best course of action. There is little doubt that the result of the analysis will yield significant future benefits for generations. The significance can be both positive and negative. Research and consultants are available to assist you in your efforts. For the best results, consider options presented by more than a single source.

**About The Author**

Jeffrey W. Craig, CLU, ChFC, AEP, is Senior Vice President of Wealth Transfer at Mercury Financial Group. Mr. Craig is a specialist in the design and implementation of advanced planning strategies for families of significant wealth, entrepreneurs and professionals. For most of these clients, this involves working with their advisors to establish, fund and leverage tax-efficient, multi-generational wealth strategies, frequently in tandem with philanthropic techniques. Contact Mr. Craig at JCraig@emercury.com, or call 214.906.1840. You may follow him on LinkedIn at www.linkedin.com/in/jeffreycraig01

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