legally speaking

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WILLS, TRUSTS & ESTATES: PLAIN AND SIMPLE

"Popular Again: Life Insurance Trusts to Hedge Against Estate Taxes"

With the prospect of estate tax exemptions going down and estate tax rates going up, life insurance is being considered again to cover potential estate taxes. One way to use life insurance as a "hedge" against estate taxes is to include an Irrevocable Life Insurance Trust (an "ILIT") as part of your estate plan.

Generally, people are unaware that the proceeds of life insurance are included in a decedent's estate for estate tax purposes (assuming the decedent owned the policy). If the proceeds are payable to a spouse or a charity, a deduction is permitted equal to the proceeds, so no estate tax will be due on the proceeds. If the proceeds, however, are payable to anyone else, they will be subject to estate tax if the estate assets, including the proceeds, exceed the estate tax exemption amounts. While the estate tax exemption amounts are currently high, one must consider the strong possibility that exemption amounts will be reduced, and tax rates increased.

One easy way to keep life insurance proceeds out of your estate is to have an ILIT own the policy. You create the ILIT; the beneficiaries and terms of the ILIT, generally, can be whomever and whatever you would like. The trust is irrevocable. If the funding of the ILIT is done properly, and certain administrative provisions are followed, the life insurance proceeds will not be included in your estate for estate tax purposes upon your death.

Life insurance is purchased for many reasons, including to protect loved ones, to pay for estate taxes and to equalize bequests to children (ex., one child gets the $5 million business and the other gets $5 million in life insurance proceeds). If you are single, have a $5 million business and $5 million of life insurance that you individually own, your estate tax bill is computed on $ 10 million, thereby subjecting your estate to New York estate tax in 2020 on $4,150,000 (resulting in over $1 million in NY estate taxes). If the life insurance had been held in an ILIT, your New York tax bill would have been computed on $5 million, resulting in $0 New York estate tax this year, saving your heirs over $1 million. If the estate tax exemptions go down, the use of an ILIT is even more compelling.

ILITs have some technical rules that your estate planning lawyer can further explain to you. Using an ILIT is a simple way to protect your family and lower your estate tax burden, and may be more attractive in view of potential decreases in estate tax exemption amounts and increases in estate tax rates.

If there is a trusts and estates topic that you would like to know more about, please feel free to email me at pmarcin@farrellfritz.com and I will do my best to cover it in a future column.

Patricia C. Marcin is a partner at the law firm of Farrell Fritz, P.C. concentrating in trusts, estates and tax law. She can be reached at pmarcin@farrellfritz.com or at 516-227-0611.

Patricia C. Marcin is a partner at the law firm of Farrell Fritz, P.C., concentrating in trusts, estates and tax law. Patricia has lived in Lloyd Harbor since 2005 with her husband John. They have two sons, Sam and Matt. Their faithful dog, Blizzard, still lives at home.