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## Life Insurance as an Estate Planning Tool

Life insurance can be a versatile and important tool in estate planning. Not only can it provide for a family's welfare in the event of the untimely death of the breadwinner, but insurance proceeds also can pay estate taxes, leaving legacies intact for the heirs.

Here is just a partial list of the benefits of making life insurance a part of your estate planning strategy:

- *It provides immediate cash at death to pay funeral expenses, debts, and final income taxes of the insured.*
  - *The cash provided by the proceeds can be made available to pay estate taxes and, thus, avoid the forced sale of an asset.*
  - *Generally, life insurance proceeds payable to a named beneficiary pass to that beneficiary free of income tax.*
  - *Proceeds from the policy can be transferred to a trust for the benefit of, for example, minor children or elderly or handicapped relatives.*
  - *Life insurance proceeds payable to someone other than the insured's estate can avoid passing through probate.*
  - *Life insurance could be used to satisfy marital settlement obligations for child or spousal support.*
  - *When the insured owns a closely-held business, life insurance proceeds may fund a buy-out of his or her interest.*
- Irrevocable life insurance trusts*

One estate planning strategy involving insurance is to establish an irrevocable life insurance trust as a way to avoid federal estate tax on the proceeds paid at the insured's death. It is important that professionals be involved in the creation of the trust in order to ensure that all the proper steps are taken.

Here's how an irrevocable life insurance trust works:

**The owner of the policy transfers it to the trust, or the trustee of the trust purchases the policy. (The creator of the trust provides the funds) Funds are provided for the trust to pay the premiums due on the policy (unless the policy has been paid up). In situations involving transfers of existing policies, in order for the proceeds to avoid inclusion in the insured's estate and, thus, escape taxation, the owner must survive for three years after the transfer.**

Another important step in establishing an irrevocable life insurance trust is to be certain that the insured has no "incidents of ownership" in the policy that connect him or her to the life insurance held by the trust. Further, the trust should have sufficient assets to pay for the premiums, though the insured may make gifts to the trust in order to pay the premiums. To minimize the gift tax consequences, special technical rules must be observed to ensure that these are gifts of "present interests".

The form of life insurance chosen (whole life, term, etc.) to be transferred to an irrevocable life insurance trust will depend on the age and situation of the insured. If existing policies are transferred, the insurance company must be notified of the ownership change. (If a large gift is involved, a gift tax return may also have to be filed, but it doesn't necessarily mean that a gift tax is due.) If new policies are purchased, all of the documentation should reflect that the trust is the owner of the policy and that the insured has no interest in it.

Life insurance can be a valuable estate planning tool that, when used properly, can provide financial security for your loved ones, after you can no longer do so.