Estate Planning

Contingent Ownership Arrangement for Survivorship Life Insurance

If you are interested in solving estate liquidity needs, but concerned with the complexity and restrictions associated with irrevocable life insurance trusts (ILITs), consider a contingent ownership arrangement as an effective alternative.

The challenge

- Gift tax strategies can get complicated when annual exclusion gifting is not a viable solution because premiums exceed the amount of available gift tax annual exclusions.
- Loss of control and flexibility can arise when estate assets are gifted to an irrevocable life insurance trust. You may need emergency access to the policy and its cash values and want the option to change the beneficiary.

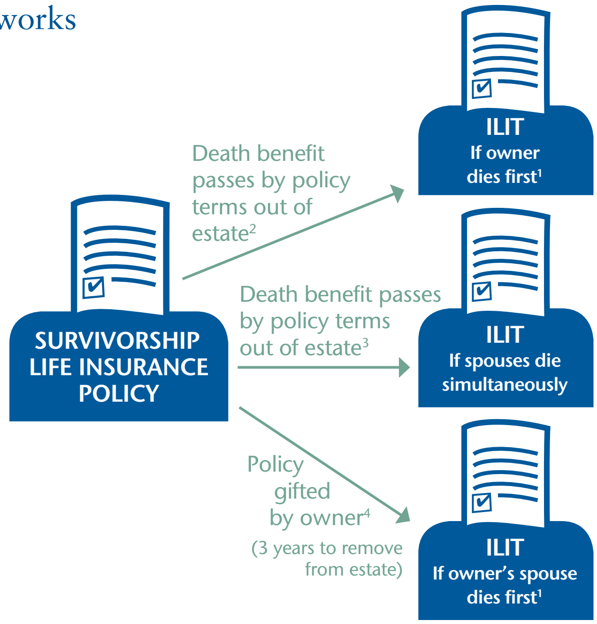
A solution

A contingent ownership arrangement can offer the simplicity of allowing one spouse to own the policy, while naming a contingent owner (an ILIT) provides flexibility.

- Eliminates the need for a complicated gift tax strategy
- Provides flexibility and emergency access to policy cash values by retaining ownership. The option exists to transfer ownership to an ILIT if and when goals change.

How it works

The spouse with the assumed shortest life expectancy is named owner of a survivorship life insurance policy. A stand-by ILIT is created and named as contingent owner of the policy in the event of the primary owner's death. The owner pays the policy premiums each year with after-tax dollars for a limited premium payment period (i.e. 5, 10 or 15 years). The goal is to achieve a paid-up policy prior to the owner's death. The beneficiary of the policy is the ILIT.



[1] Additional premium may be needed based on timing of death.

[2] Cash value of policy is included in estate since no death benefit is payable; death benefit out of estate at first death.

[3] Cash value of policy is included in estate.

[4] See considerations on back.

Benefits

- May avoid gift tax issues and financing arrangements typically associated with making annual premium payments for the purchase of a very large survivorship life insurance policy.
- Offers policy owner emergency access to policy values prior to death.
- Avoids the need to have a current active trustee and for the trustee to annually distribute “Crummey” letters.
- Is particularly appropriate for insureds who have ample opportunity to complete premium payments before the primary owner passes away.
- Once the policy is paid for and the primary owner passes away, the policy becomes ILIT-owned and the death proceeds will be excluded from the estate of the surviving spouse at his/her passing.
- The overall cost of insurance is lower since no death benefit needs to be purchased to support a financing plan.

Considerations

- When the primary owner dies first, the policy’s cash value is included in his or her estate. This result may be partially or completely mitigated by the estate tax personal exemption, or credit-shelter amount, in the year of death. The amount of estate tax personal exemption available for the decedent’s (primary ower’s) credit shelter trust will be reduced by the value of the policy included in the decedent’s estate.
- If the owner’s spouse dies first, the policy will need to be gifted to the ILIT to remove the death proceeds from the owner’s estate. The amount of the gift would be the fair market value of the policy. A three-year waiting period will be necessary before the death benefit is removed from the owner’s estate.
- Alternatively, the policy may be purchased by the ILIT from the primary owner at its fair market value using cash gifted to the ILIT by the owner. This approach will avoid the three-year inclusion rule for gifted policies.
- Whether the policy is gifted or sold to an ILIT after the owner’s spouse dies, a gift tax strategy may need to be developed if additional premiums are required.

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