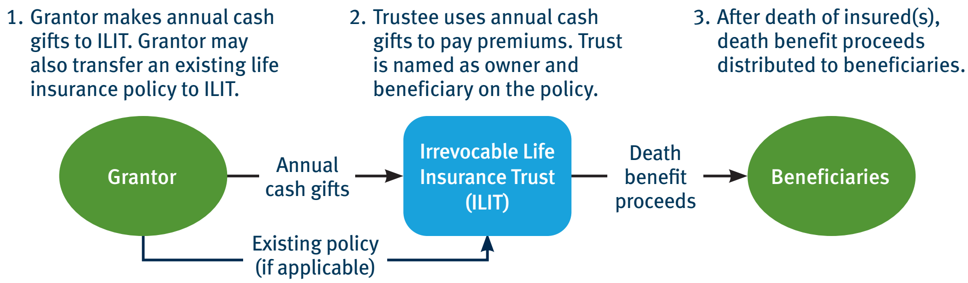
Life Insurance as an Estate Planning Tool

Wealth Planning | Estate and Tax Planning

Life insurance can be an effective tool for addressing certain estate planning situations. Individuals can use life insurance to ensure a more equitable division of shares for beneficiaries and create liquidity to address potential estate tax exposure. When using life insurance as an estate planning tool, individuals should give special consideration to policy ownership. If an individual owns a life insurance policy in his or her name, the death benefit may be included in his or her taxable estate – potentially creating or increasing estate tax exposure. On the other hand, if an individual creates an irrevocable life insurance trust (ILIT) to own the policy, the death benefit will not be included in his or her taxable estate.



Color Key	
Green	Assets subject to probate, included in taxable estate, and eligible for a step-up in cost basis.
Blue	Assets avoid probate, not included in taxable estate, and not eligible for a step-up in cost basis.

Life Insurance Policy Specifics. The owner and beneficiary of the life insurance policy should be the ILIT. The insured should be the grantor(s). The grantor is the person who creates the trust.

Estate and Gift Tax Considerations. If an individual transfers an existing policy to an ILIT, he or she must live at least three years beyond the date of the transfer for the death benefit to be removed from his or her estate. Furthermore, the transfer constitutes a taxable gift, which requires the filing of a gift tax return (Form 709), though tax is usually not owed. The value for gift tax purposes is the fair market value of the policy on the date of the gift. Insurance companies must provide this value, known as the interpolated terminal reserve. It is often similar to the policy's cash value. If the ILIT is the initial owner of the policy, the policy typically never becomes part of the grantor's taxable estate.

Annual Exclusion Gifts and Crummey Notices. Contributions to the ILIT may qualify as annual exclusion gifts, so long as the trustee sends a Crummey notice to each beneficiary. These notices inform the beneficiaries of their right to withdraw their pro rata share of the contributions to the trust. In most cases, the beneficiaries waive their right to withdraw the contributions. In 2025, an individual may make annual exclusion gifts up to $19,000 per recipient.

Payment of Life Insurance Premiums. The trustee of the ILIT uses trust contributions (not withdrawn by beneficiaries) to pay life insurance premiums. Depending on the size of the premium and number of trust beneficiaries, the grantor may be able to cover all or a portion of the premium through annual exclusion gifts.

Beneficiaries. The grantor specifies the beneficiaries of the proceeds in the trust document. A beneficiary's share of proceeds may be distributed outright or held in further separate trust.

Reimbursement for Estate Taxes Paid. The ILIT generally should not pay any estate taxes owed by the grantor directly. Doing so may cause trust assets to be included in the grantor's taxable estate. Instead, the ILIT can reimburse beneficiaries who pay an estate tax liability. The ILIT may also generate liquidity for estate taxes by purchasing assets from the grantor's estate or loaning assets to the grantor's estate.

For more information about ILITs and using life insurance for estate planning purposes, contact your local attorney and Stifel Financial Advisor.

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