Estate Tax Liquidity, Wealth Replacement and ILITs

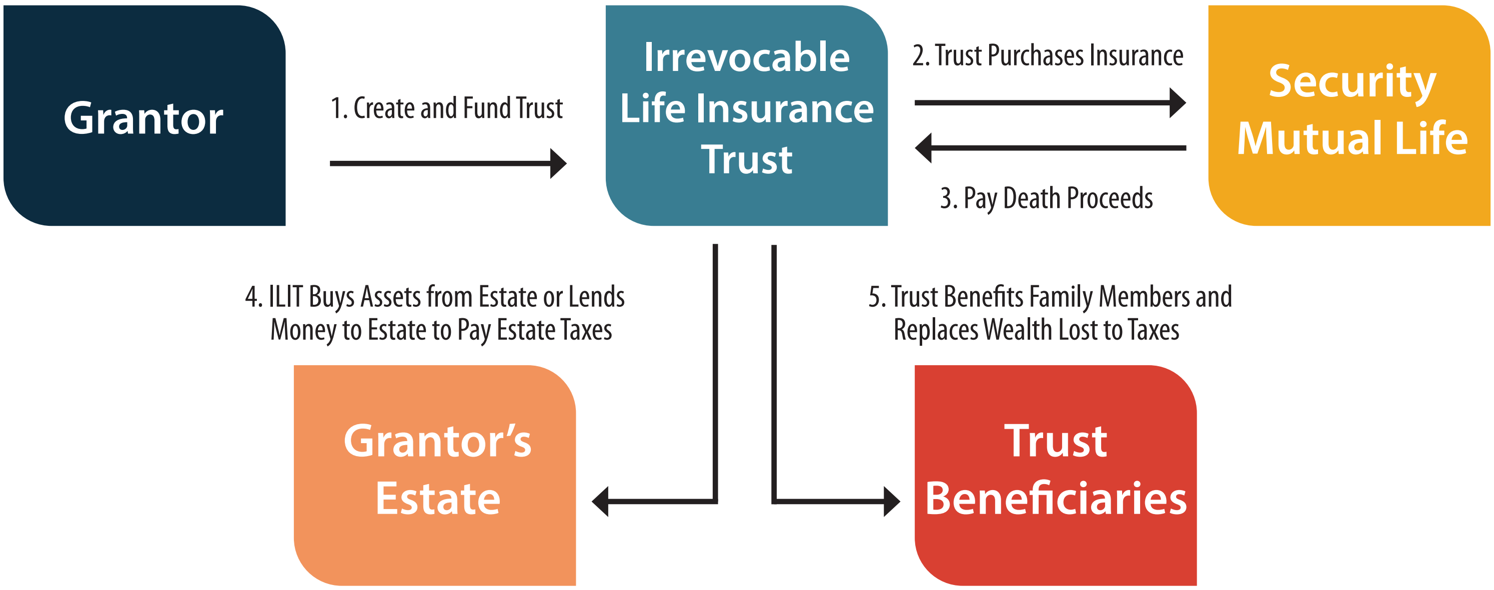
Business owners and other high-net-worth individuals often have a tax issue that most Americans don't, and that is the possibility that at death a significant portion of their estate will be consumed by federal and/or state estate and inheritance taxes (collectively referred to as "estate taxes"). Certain of their assets may also be consumed by income taxes at their deaths. These assets are known as IRD ("income in respect of a decedent") assets, which include traditional IRAs, annuities and qualified retirement plans that were untaxed while the individual was alive.

Complicating matters is that many business owners and high-net-worth individuals may have their wealth concentrated in assets that are illiquid, such as a business, commercial real estate, private equity, collectibles, and more. Illiquid assets are a complication because the law generally requires that estate taxes be paid in cash, within nine months of death. To quickly raise that cash, the decedent's estate will need to liquidate the liquid assets, such as investment and savings accounts, or attempt to sell the illiquid assets in a hurry and potentially at a discount in a "fire sale." Neither option is generally desirable. The use of the assets to pay off estate and income taxes will also diminish the inheritance the decedent intended to leave to family members, friends and charities.

Fortunately, there is a relatively simple way to create the liquidity needed to pay the estate and income taxes, and to avoid diminishing the intended legacy to heirs and charities, without the need to use assets to pay taxes. Life insurance held in an irrevocable life insurance trust ("ILIT") is a popular estate-planning solution that addresses these concerns. An irrevocable trust is required to hold the life insurance because personally owned life insurance increases the size of the taxable estate by the death benefit amount for estate tax purposes. The ILIT will avoid that result.

See How It Works on the Next Page ➔

How It Works:



1. The ILIT is created by working with an estate-planning attorney. You are the grantor of the trust. Because the ILIT is such a common planning strategy, estate-planning attorneys are well-versed in it. You will also designate a trustee to manage and administer the trust. The beneficiaries of the trust are typically the family members to whom you intend to leave your assets. The ILIT is generally funded with cash gifts. Gifting is typically done each year.

The ILIT uses that money to purchase a life insurance policy and pays the annual premiums using the ongoing gifts. Depending upon how the trust is set up, the trust could purchase a policy on your life or the joint lives of you and your spouse (a "survivorship" policy). If the trust is set up to purchase life insurance on your life only, your spouse is typically also a beneficiary of the trust. If the trust purchases a survivorship policy, typically only your children and lineal descendants are trust beneficiaries.

2. Upon the death of the insured(s), the ILIT receives the life insurance proceeds.

3. The ILIT can now either lend money to your estate for the payment of estate taxes, or it can purchase the illiquid assets from your estate. This results in the conversion of illiquid assets to cash avoiding the need for a "fire sale."

4. Alternatively, the insurance proceeds can act as a replacement of the wealth that was lost to taxes. Of course, the life insurance proceeds can also be used to meet the continuing income needs of the surviving family.

There are several other significant benefits of an ILIT, including:

- The trustee of the ILIT can invest, manage and distribute the insurance proceeds and other assets held by the trust for the benefit of your children and lineal descendants, regardless of their age, and/or your surviving spouse.
- The trust can protect the insurance proceeds from potential creditors of the trust beneficiaries.
- Depending upon how the trust was created and funded, the trust could last for many years to benefit future generations such as grandchildren, great grandchildren and beyond. The insurance proceeds and other assets held by the trust could also be kept out of the estate tax system during those years.

Conclusion

We have briefly touched upon one of the most popular estate-planning strategies to create liquidity to pay estate taxes or to replace wealth lost to taxes. While the concept is fairly easy to understand and apply, the strategy is more complex than described, and that's why you need to work with your estate-planning team to determine whether this makes sense for your unique situation. Your Security Mutual life insurance advisor can assemble your team and coordinate with your estate-planning attorney and tax professional to review your situation.

For More Information Contact:

Contact your Security Mutual life insurance advisor today to get the process started.

The information presented is designed to provide general information regarding the subject matter covered. It is not intended to serve as legal, tax or other financial advice related to individual situations, because each person's legal, tax and financial situation is different. Specific advice needs to be tailored to your particular situation. Therefore, please consult with your own attorney, tax professional and/or other advisors regarding your specific situation.

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