Life Insurance for Lifetime Needs and Estate Tax Liquidity Using a SLAT

For those individuals and families who have a potential federal and/or state estate and inheritance tax (collectively referred to as "estate taxes") issue, permanent life insurance, such as whole life insurance, held inside of an irrevocable life insurance trust, or ILIT, is a very common strategy to address this issue.

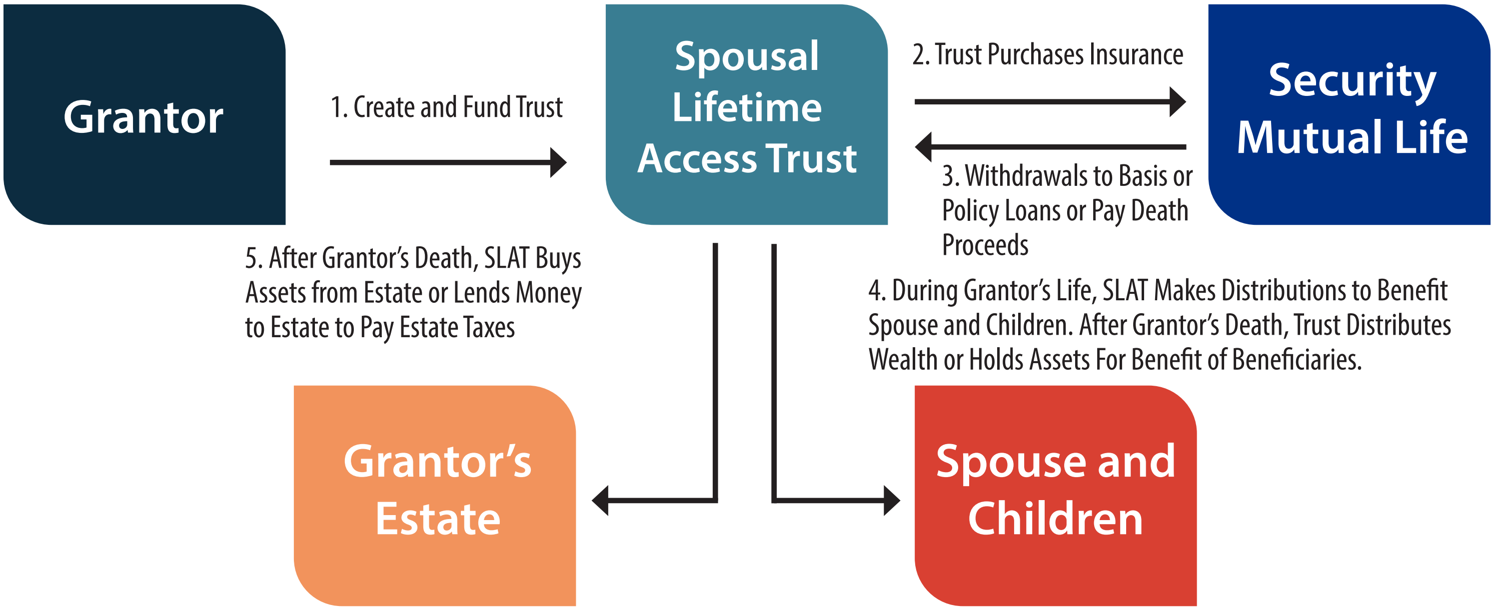
The law provides that individually owned life insurance would result in the death benefits being included in the calculation of your gross estate, possibly exacerbating your estate tax issue. Thus, an ILIT is often recommended to own the life insurance and ensure that the insurance proceeds are not counted for estate tax purposes. At your death, the ILIT collects the insurance proceeds and uses it to purchase assets from your estate or to loan money to your estate to cover estate taxes. The proceeds can also be used to replace the wealth lost to taxes for your heirs.

While you are alive, however, you probably still want to have access to the cash values of the life insurance policy to meet lifetime needs, such as paying for a college education, supplementing retirement income, etc. However, the law provides that if you have access to the cash values, even if the policy is owned by the ILIT, the life insurance will be pulled back into your estate and counted for estate tax purposes.

Fortunately for married couples, a properly drafted ILIT may still provide indirect access to the cash values. (The strategy also works if you're not married but have other heirs such as children—but it doesn't work as well.) This type of trust is known as a SLAT or Spousal Lifetime Access Trust. A SLAT is an irrevocable trust, such as an ILIT, with provisions that include the spouse as the primary beneficiary of the trust. The trustee is also empowered to make discretionary distributions to any of the trust beneficiaries. The trustee would typically be a "disinterested" individual or institution who would not benefit from the trust, such as a friend, attorney, CPA or financial institution.

See How It Works on the Next Page →

How It Works:



1. You will need to work with an estate-planning attorney to create the SLAT. You will also designate a disinterested trustee to manage and administer the trust. The primary beneficiary of the trust will be your spouse and children or other family members to whom you intend to leave your assets. The SLAT is generally funded with money that you gift into the trust.[i]

2. The trustee uses the money to purchase a Security Mutual Life permanent life insurance policy on your life and pays the premiums.

3. During your lifetime, the trustee can take withdrawals from the policy or take loans from the policy cash values.[ii] At your death, the SLAT receives the life insurance proceeds.

4. The withdrawals or policy loans can then be distributed to your spouse as a trust beneficiary, who in turn can either give the money back to you or use it for whatever purpose you intended. This is the lifetime access nature of a SLAT. Upon your death, the trust can distribute the assets to your family or continue holding and managing the assets for the benefit of your beneficiaries, depending upon how the trust is designed.

5. With regard to estate taxes, the death benefits can be used by the SLAT to either lend money to your estate for the payment of estate taxes, or to purchase the illiquid assets from your estate. This results in the conversion of illiquid assets to cash, avoiding the need for a "fire sale." The insurance proceeds may also replace wealth that was lost to taxes.

The SLAT is primarily designed for those with spouses because gifts between spouses are not subject to any limitations due to the unlimited gift tax marital deduction.[iii] If you don't have a spouse, distributions can be made to your children, who in turn can give the money back to you. However, children are limited in the amounts they can gift to you. They are subject to the annual gift exclusion amount and/or their lifetime gift tax exemption amount.

The SLAT may offer other benefits as well, depending upon how it is drafted and managed, including:

- Professional management of the assets for the benefit of your family members and heirs.
- Protection of the trust assets from potential creditors of the trust beneficiaries.
- Creation of a benefit for 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

SLATs are one of the most popular estate-planning strategies to create liquidity to pay estate taxes or to replace wealth lost to taxes through the use of life insurance, while still maintaining indirect access to the cash values during your lifetime. 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 help assemble your team and coordinate with your estate-planning attorney and tax professional to review your situation. Contact your Security Mutual life insurance advisor today to get the process started.

For More Information Contact:

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[i] Gifting is typically done each year to take advantage of what is known as your annual gift exclusion amount (currently $15,000 per donee for 2021). A lump sum gift may also be made to take advantage of your lifetime gift tax exemption amount, which is subject to change due to political considerations. While the current amount for 2021 is $11.7 million, in the not-too-distant past, it was just $1 million, and there have been many recent Congressional proposals to reset it to that level.
[ii] Loans from the policy will reduce the death benefit and cash surrender value and may cause the policy to lapse. Lapse of a policy with a loan may have tax consequences.
[iii] We're assuming that both spouses are U.S. citizens. Different rules apply for non-citizens.

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