The Principal Financial Group®

Irrevocable Life Insurance Trust

What is an irrevocable life insurance trust?

An irrevocable trust is a trust in which the grantor completely gives up all rights in the property transferred to the trust, and retains no rights to revoke, terminate or modify the trust in any material way.

When such a trust holds a life insurance policy, usually on the life (lives) of the grantor and/or a spouse, it is an irrevocable life insurance trust. If withdrawal powers are given to the beneficiaries, it may also be referred to as a "Crummey trust," so named after the taxpayer in a famous 1968 court case.

Irrevocable life insurance trusts (ILITs) are used to accomplish some or all of the following objectives:

- To help meet the liquidity needs of the grantor's estate;
- To help provide for the income needs of survivors;
- To avoid the estate taxation of the life insurance death proceeds; and
- To shelter property in the trust from creditors at death.

Funded vs. unfunded trusts

In a **funded** life insurance trust, the grantor initially transfers cash or other property to the trust which the trustee uses to pay premiums. The major drawback of the funded life insurance trust is that income earned on the property inside the trust will be taxed to the grantor if it can be used to pay premiums on a policy on the life of the grantor or the grantor's spouse.

In an **unfunded** life insurance trust, the grantor makes annual gifts to the trustee to pay premiums.

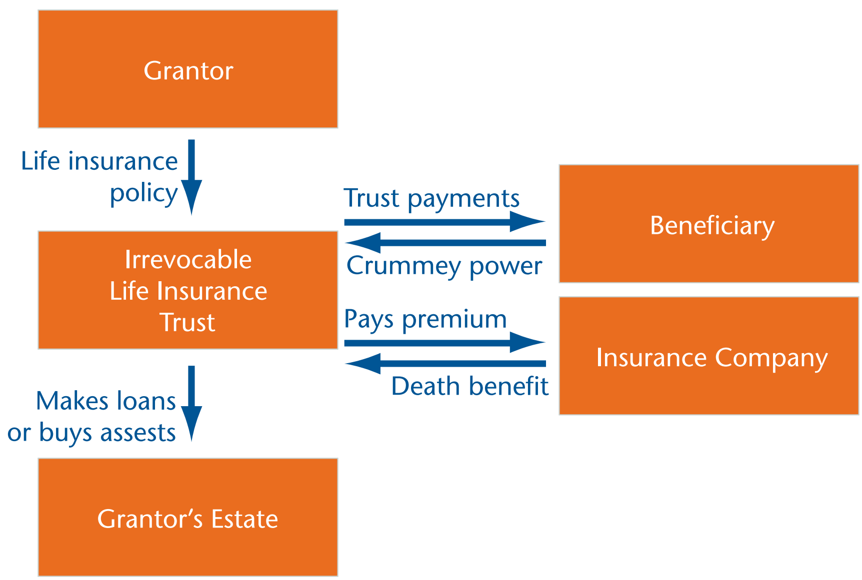
These annual transfers are considered gifts to the trust beneficiaries. If the trust beneficiaries cannot "enjoy" these gifts immediately, the gifts would ordinarily be future interests. That means no annual exclusion ($13,000 in 2010) is available to shelter the annual transfers from the federal gift tax. However, trust beneficiaries can be given special withdrawal powers, called Crummey powers, to convert their interests into present interests that qualify for the annual exclusion.

Avoiding the estate tax

The trust corpus, including the life insurance, generally avoids being included in the grantor-insured's gross estate, as well as the surviving spouse's gross estate, if:

- The trust is irrevocable;
- The grantor is not the trustee;
- The grantor has no incidents of ownership over the insurance policy;
- The insurance proceeds are only used to purchase estate assets or to make loans to the estate in reasonable, arm's-length transactions, not to pay estate costs in a direct manner; and
- The insured lives for at least three years after transferring the policy to the trust.

How the irrevocable life insurance trust works



- The grantor transfers a life insurance policy to the trust (or preferably, the trustee applies for a new policy, thereby avoiding the possibility that the policy would be included in the grantor's gross estate).
- The grantor transfers cash annually to the trust which can be sheltered from the gift tax by the gift tax annual exclusion, through the beneficiary's Crummey power.
- The trustee makes premium payments.
- At the grantor's death, the trust receives the death benefit from the policy.
- The trust gives the trustee the power to make loans to the grantor's estate, or to purchase assets from the estate, to provide the estate with funds to help pay estate settlement costs.

WE'LL GIVE YOU AN EDGE®

Principal National Life Insurance Company and Principal Life Insurance Company, Des Moines, Iowa 50392-0001, www.principal.com

BB10181 | 06/2010 | #t10061801s5 | Do not use after 06/2012