



Ownership of Life Insurance: Estate Planning

What are the ownership issues of life insurance?

In estate planning, life insurance is purchased for several reasons: (1) to provide cash to the insured's family for daily living expenses, (2) to provide cash for potential death taxes and estate expenses, and (3) to provide a shelter from income taxes (for beneficiaries), potential estate taxes, or gift taxes (for insureds). In order to ensure that your beneficiaries receive the maximum benefit from life insurance policies on your life, you must structure ownership of these policies to minimize income and potential estate taxes.

Tip: Another way to avoid taxes is to properly designate the beneficiaries.

Who should own your life insurance?

Not you (the insured), if your estate is more than the applicable exclusion amount

Life insurance proceeds from policies on your life may be includable in your estate for estate tax purposes if you own the policy outright, have any "incidents of ownership" in the policy at the time of your death, or transfer ownership of the policy within three years of your death. Inclusion of life insurance proceeds in your estate is not a problem if your estate (including any includable life insurance proceeds) is less than or equal to the applicable exclusion

amount (\$3.5 million in 2009). If your taxable estate (excluding any includable life insurance proceeds) exceeds the applicable exclusion amount, you (the insured) should consider alternate ownership of policies on your life.

Technical Note: "Incidents of ownership" is a legal term that refers to the right of the insured to control the economic benefits of the policy. This definition encompasses more than outright ownership of the policy and includes the power: (1) to change the beneficiaries of the policy, (2) to pledge the policy for a loan, (3) to surrender or cancel the policy, (4) to assign the policy, or (5) to borrow against the surrender value of the policy. A reversionary interest in a life insurance policy is also treated as an incident of ownership in that policy and will result in inclusion of the value of the policy in the insured's estate if the value of the reversionary interest immediately before the insured's death exceeds 5 percent of the value of the policy. A reversionary interest in a life insurance policy includes the possibility that the policy or its proceeds may return to the decedent or his or her estate or may be subject to a power of disposition (e.g., a power of appointment) by the decedent.

See disclosures on final page.

Not your spouse if you live in a community property state, if your estate is more than the applicable exclusion amount

Community property states treat all types of community property, including life insurance, as being owned one-half by each spouse. Thus, one-half of a life insurance policy on your life that is owned by your spouse may be includable in your estate for estate tax purposes. As discussed above, this is not a problem if your estate (including any includable life insurance proceeds) is less than or equal to the applicable exclusion amount. However, if your estate (excluding any otherwise includable life insurance policies) exceeds the applicable exclusion amount, you should consider having ownership of the policy reside with someone other than your spouse.

Another individual

One person can own a policy insuring the life of another. Proceeds of such a policy will not be includable in the insured's estate, but the value of the policy may be includable in the owner's estate if the owner dies before the insured and in a year in which estate taxes are imposed.

Premiums may be paid by the owner, but not from joint assets or community property belonging to the insured.

An irrevocable trust

An irrevocable life insurance trust (ILIT) is a type of trust that may be used to keep life insurance proceeds out of the insured's estate for estate

tax purposes. The trustee of the ILIT is the owner of the policy, and the ILIT is the beneficiary. Upon the insured's death, the proceeds are distributed to the ILIT and distribution to the beneficiaries of the ILIT is made according to the terms of the trust agreement.

Caution: An ILIT is a complex estate planning tool and must be properly created to be effective. If you are interested in taking advantage of such a device, you should seek the assistance of an estate planning professional in your state.

What if you transfer an existing policy to another owner?

The proceeds may be taxable if you die within three years after the transfer and in a year in which estate taxes are imposed

If you own a policy on your life, you may want to transfer ownership to another individual (e.g., to the beneficiary) to avoid inclusion of the proceeds in your estate. Transferring ownership of a policy is easy: Simply complete a change of ownership form provided by your insurance company. Remember, though, that even if you transfer ownership of an existing policy to another individual, it can be included in your estate if you die within three years of the transfer and in a year in which estate taxes are imposed.

Disclosures – Important – Please Review

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