What Is An Irrevocable Life Insurance Trust (ILIT)?

If you are the owner of a life insurance policy, the death benefits will be part of your taxable estate when you die. An ILIT is a trust that owns your life insurance policies (and, sometimes, other assets you move into it). Because the trust owns your life insurance benefits, they aren't included in your personal estate for estate tax purposes. A trustee is responsible for paying life insurance premiums and managing the trust's assets. Premiums are usually funded by gifts you make to the trust using the annual gift-tax exclusion amount for each beneficiary of the trust. After your death, the trustee ensures that the proceeds of your insurance policies are paid to the trust's beneficiaries. There are pros and cons to using an ILIT:

PROS

- Reduces estate taxes by removing insurance proceeds from your estate;
- The trust assets do not pass through probate;
- The trust proceeds are a source of ready cash beneficiaries can use to pay estate taxes;
- Proceeds held in the trust may be protected from the creditors of the trust beneficiaries; and
- If you are married, you can arrange for your spouse to receive distributions from the trust during his or her lifetime (prior to children or other beneficiaries' final receipt).

CONS

- Once the trust is set up, you can't change its terms;
- Once you transfer a life insurance policy to the trust, you give up control over that policy, can't make loans or withdrawals of the cash value of that policy, and can't change its beneficiaries;
- Trustees and legal advisors must carefully handle gifts made to the trust to prevent triggering gift taxes; and
- Professional trustees usually charge annual administration fees and may not agree to manage trusts that own insurance policies or the death benefit from insurance policies, where the total is less than $1M.

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