

## **Don't Lose the Gift Tax Exclusion for Transfers to Your ILIT**

You've probably heard that federal gift and estate taxes can eat up as much as half of an estate. Fortunately, refuge can be found through an irrevocable life insurance trust (ILIT). This invaluable estate planning tool can shelter transfers beyond the \$650,000 gift and estate tax exemption. It can be funded with \$10,000 annual exclusion gifts, incurring no federal gift taxes.

### **How an ILIT Works**

The purpose of an ILIT is to keep the trust's funds (the proceeds from an insurance policy on your life) out of your estate. You then name a trustee to control the trust. The trust is funded with yearly gifts providing income to pay future life insurance premiums.

To ensure that cash contributions to the ILIT qualify for the gift tax annual exclusion, you must give one or more beneficiaries the right to withdraw amounts contributed to the trust. This right of withdrawal is often known as a Crummey power (named after a Mr. Crummey's tax case), and the type of trust is often referred to as a Crummey trust. The Crummey power only exists for a limited period of time after the contribution is made. The beneficiary's right to the immediate possession and enjoyment of the funds gifted to the trust, whether or not actually withdrawn, converts what would otherwise be a gift of a future interest (which would not qualify for the annual gift tax exclusion) to a gift of a present interest (which does qualify for the annual gift tax exclusion).

The IRS has ruled that for a Crummey right of withdrawal to be a presently exercisable right, a beneficiary must have a reasonable time to learn of the existence of the right and to exercise it before it lapses.

### **Giving Proper Notice**

The safest method of ensuring this is to require in the governing trust instrument that the trustee give the beneficiary notice of the gift to the trust and the withdrawal right within a reasonable amount of time before the power lapses. The IRS has not defined what constitutes a reasonable amount of time. Based on certain rulings and on custom, this withdrawal period is generally 30 to 60 days.

Whether notice to a beneficiary must be given immediately after the gift to the trust depends on when the withdrawal right lapses. If the trust states that the withdrawal right lapses 30 or 60 days after the contribution is made, notice should be given soon after the contribution to allow the beneficiary a reasonable time period in which to exercise the right. Although there is no requirement that written notice be given, some written communication will be essential to demonstrate that the beneficiaries did have knowledge of the contribution and a reasonable time to exercise their withdrawal right.

### **For the Long Haul**

After the first year or so, providing an annual notice should become routine, with the annual premium notice from the insurer serving a reminder. Until then, it is up to the trustee, grantor, insurance agent and attorney to work together to ensure notices are sent.

In the course of time, it may come to your attention that an individual trustee who has been responsible for sending the written notices has not done so consistently and in a timely manner. In such a situation, in addition to giving current notice, you may consider having the beneficiary sign a one-time waiver of notice. But the IRS has issued conflicting rulings on whether a beneficiary can waive the notice requirement up front.

A better approach would be to have the beneficiary acknowledge the existence of his or her right of withdrawal. This can be done with a simple affidavit signed by the beneficiary stating that he or she was aware of the right to withdraw funds from the trust and did not exercise it. The affidavit should refer to the beneficiary's withdrawal rights for each year that notice was not given.

### **Ask the Experts**

If you have any questions or concerns about fulfilling the technical requirements of notice under an irrevocable life insurance trust, please let us know. Our professionals are here to help you every step of the way.

### **When Beneficiaries Are Minors**

If the beneficiaries of a Crummey trust are minors and the trust provides that the minor's right of withdrawal may be exercised by the minor or his or her guardian, then legal notice must also be given to the guardian or, if none, to a parent qualified as a natural guardian pursuant to state law. The class of individuals who can receive notice and exercise powers on behalf of the beneficiary should not include the grantor -- otherwise the trust and the insurance proceeds may be included in the grantor's estate. The estate tax provisions of the Internal Revenue Code prohibit the grantor of a trust from retaining certain powers, which could affect the beneficial enjoyment of the transferred property, even if such powers are exercisable in a fiduciary capacity.