

Don't procrastinate if you plan to transfer ownership of your life insurance policy

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Generally, the proceeds of your life insurance policy are included in your taxable estate. You can remove them by transferring ownership of the policy, but there's a catch: If you wait too long, your intentions may be defeated. Essentially, if ownership of the policy is transferred within three years of your death, the proceeds revert to your taxable estate.

Eliminating "incidents of ownership"

The proceeds of a life insurance policy are subject to federal estate tax if you retain any "incidents of ownership" in the policy. For example, you're treated as having incidents of ownership if you have the right to:

- Designate or change the policy's beneficiary;
- Borrow against the policy or pledge any cash reserve;
- Surrender, convert or cancel the policy; or
- Select a payment option for the beneficiary.

You can eliminate these incidents of ownership by transferring your policy. But first you need to determine who the new owner should be. To choose the best owner, consider why you want the insurance, such as to replace income, to provide liquidity or to transfer wealth to your heirs.

Understanding the ILIT option

An irrevocable life insurance trust ("ILIT") can be one of the best ownership alternatives. Typically, if you transfer complete ownership of, and responsibility for, the policy to an ILIT, the policy will — subject to the three years mentioned above — be excluded from your estate. You'll need to designate a trustee to handle the administrative duties. It might be a family member, a friend or a professional. Should you need any additional life insurance protection, it would work best if it were acquired by the ILIT from the outset.

An ILIT can also help you accomplish other estate planning objectives. It might be used to keep assets out of the clutches of creditors or to protect against spending sprees of your relatives. In addition, as long as the policy has a named beneficiary, which in the case of an ILIT would be the ILIT itself, the proceeds of the life insurance policy won't have to pass through probate.

The sooner, the better

If transferring ownership of your life insurance policy is right for you, the sooner you make the transfer, the better. Please contact us with any questions regarding life insurance in your estate plan or ILITs.

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