

## **Reduce or Eliminate Your Estate Tax** **by Michael K. Elson, Attorney at Law**

Did you know that your heirs may have to liquidate your rental properties immediately after your death, unless you create an Irrevocable Life Insurance Trust (ILIT)?

Most people are interested in passing their wealth to their heirs. With the demise of the baby-boomer generation, an enormous transfer of wealth will occur during the coming years. The government is poised to capture this wealth through the estate tax, which is imposed upon death.

This device can generate enormous amounts of cash for your heirs, which can be used to pay the estate tax.

Currently, the Federal estate tax exemption amount is \$1.5 million for individuals and \$3 million for married couples. Any amount over the exemption will be taxed (Federal estate taxes average around 45%). Furthermore, this tax must be paid within nine months after you die.

Few estates hold the cash reserves required to pay the estate tax. As a result, heirs are forced to sell sufficient assets so the estate tax can be paid. Because of the narrow time constraints, heirs are often rushed into transactions which may be less than favorable.

Parents and offspring might not want or even realize that the family home, which has been in the family for many years, requires immediate liquidation to pay the estate tax. Parents who have invested wisely regarding their portfolio of income properties often desire their children to inherit these properties. Instead, the heirs will be forced to quickly liquidate enough of the property to generate sufficient cash to pay the estate tax. Most often, this is not what parents want or envision for their legacy.

Fortunately, there is a device called the Irrevocable Life Insurance Trust (ILIT) which can reduce or eliminate your estate tax cost. This device can generate enormous amounts of cash for your heirs, which can be used to pay the estate tax. When an ILIT is used to purchase and own the life policy, the proceeds are not included in the estate of the insured, and therefore are not taxed. The proceeds go to the beneficiaries completely income and estate tax free, regardless of the size of the decedent's estate. The lump sum of cash can be used for any purpose, such as paying off a mortgage/s, but most often to pay the estate taxes, so the family can retain the real property assets.

Unfortunately, the proceeds of an ordinary life insurance policy, owned by an insured, are included in the estate of the insured. If the estate value is well over the exemption amount, the life insurance proceeds are taxed at nearly 50 percent. Consequently, a policy without an ILIT offers only limited benefits.

For tax purposes, the proceeds of the ILIT are not part of the estate because the policy is owned by the irrevocable trust, rather than the insured. The ILIT purchases the policy (a second-to-die policy for a married couple) and pays the premiums. The insured establishes the ILIT and gifts money to it every year, utilizing the annual gift tax exemption. For every dollar spent on premiums, typically more than five dollars in proceeds are generated, completely tax-free. If, however, the money which can be used to pay the premiums instead remains in the estate, it may be taxed at nearly fifty percent before it is inherited. More specifically, for every liquid dollar held within the estate over the exemption amount, the heirs can either receive about fifty cents, or that same dollar can generate up to five dollars or more in tax-free proceeds.

Generating extra cash to pay for the insurance is easier than most people realize. Since qualified retirement funds (IRAs, 401k, or Keoghs) left in the estate at the time of death will be subject to income as well as estate tax, it's a good idea to use IRA funds (after age 59½) to pay the premiums on an ILIT policy, if tax deferred retirement money is not needed for living expenses. This is money well spent since the overall tax rate on inherited retirement plan proceeds can be as high as 85%.

ILITs involve complex tax and estate planning issues. They must be assessed considering the unique requirements and situations of each estate. Therefore, as with any estate planning

and asset protection device, it is essential you consult with a qualified attorney who is knowledgeable in these areas, to determine if the Irrevocable Life Insurance Trust is right for you.

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