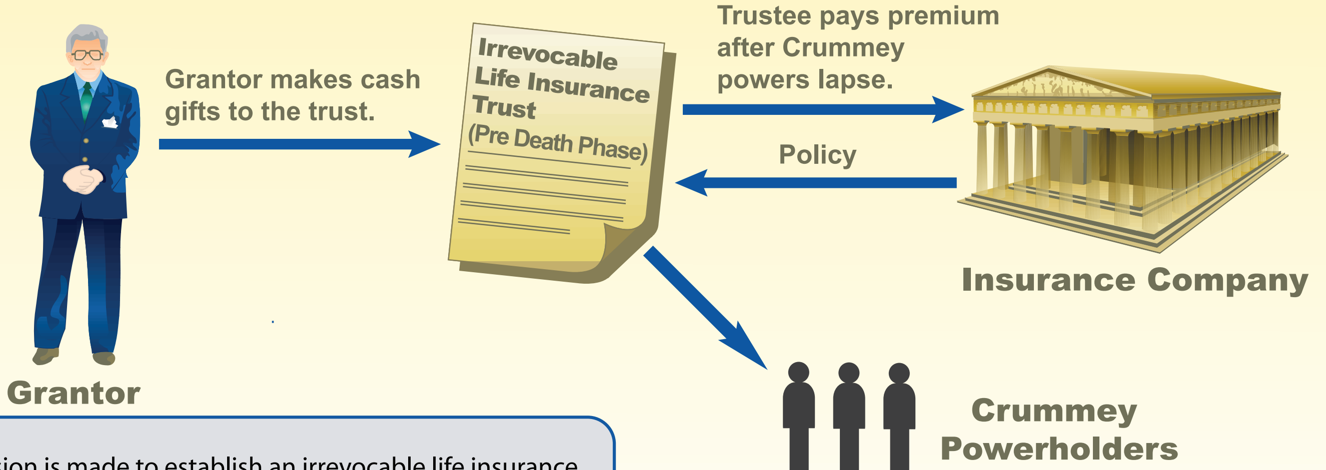
Irrevocable Life Insurance Trust: Source of Estate Liquidity

The primary purpose of using an irrevocable life insurance trust is to exclude life insurance policy proceeds from taxation in the estate of the insured and the insured's spouse. The life insurance policy itself is important for estate liquidity and as a source to augment wealth for the benefit of the grantors heirs.

During Grantor's Lifetime:

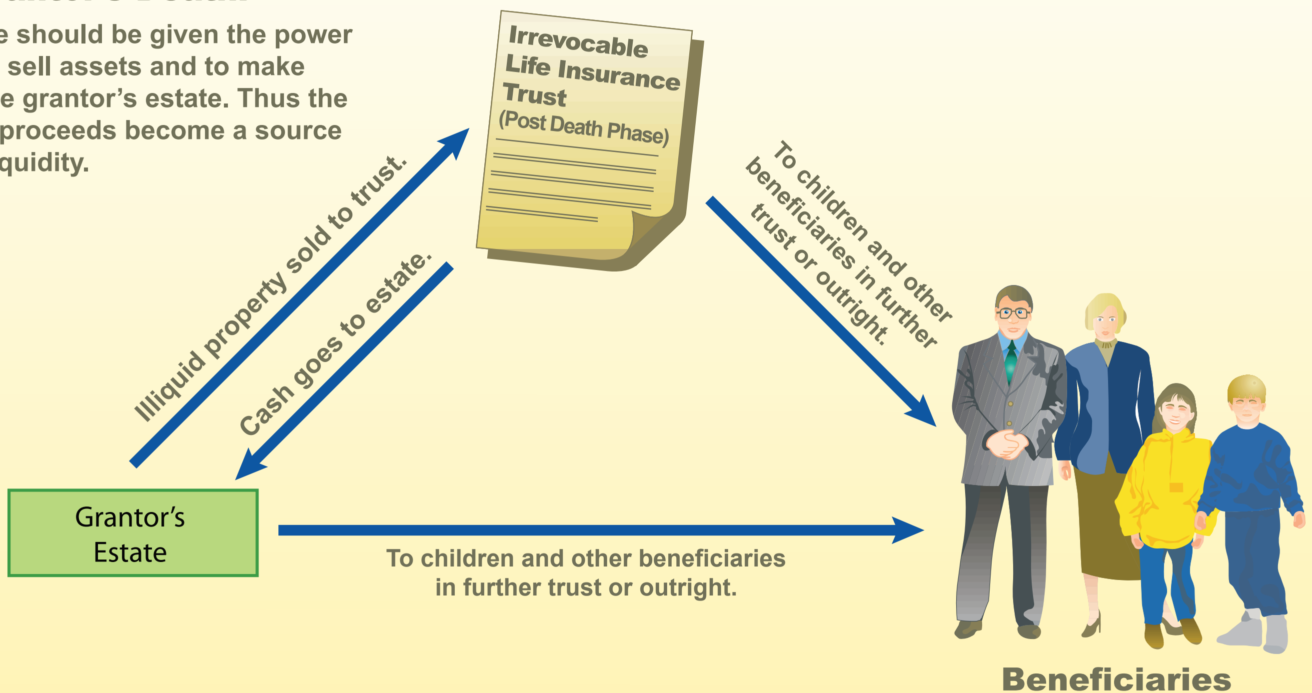


Where a decision is made to establish an irrevocable life insurance trust with a policy to be newly issued, the 3-year rule (I.R.C. §2035) can be avoided by having the policy applied for by, and initially issued to, the trust as owner. If this is properly accomplished, the insurance proceeds will not be includable in the insured's gross estate even if he should have the misfortune of living less than three years thereafter. In general, the trust should be established first, with a transfer of cash from the grantor to be used to pay the initial premium. The trustee would then submit the formal application, with the trust as the original applicant and owner.

The Crummey withdrawal right transforms an ordinarily non-excludible gift of a future interest into a gift of a present interest that qualifies for the gift tax annual exclusion.

After Grantor's Death:

The trustee should be given the power to buy and sell assets and to make loans to the grantor's estate. Thus the insurance proceeds become a source of estate liquidity.



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