Money Matters

December 1, 2024

Skloff Financial Group Question of the Month

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Q: We read ‘How a Gift Can Be a Tax Dream or a Tax Nightmare’ Part 1 and Part 2. We also read ‘How To (Legally) Avoid Taxes When Selling Your Home’ Part 1, Part 2 and Part 3. Furthermore, we read ‘How Gifting Versus Selling Your Home Can Be a Tax Dream or a Tax Nightmare’ Part 1, Part 2 and Part 3. Then, we read ‘How a Step-Up in Basis Can Be a Tax Dream’ Part 1, Part 2 and Part 3. Furthermore, we read ‘How Community Property States Versus Separate Property States Can Be a Tax Dream or a Tax Nightmare’ Part 1, Part 2 Part 3 and Part 4. Lastly, we read ‘How the Estate Tax Exemption Can Be a Tax Dream‘ Part 1, Part 2 and Part 3. Can you provide details on the Irrevocable Lie Insurance Trust (ILIT)?

The Problem – The Estate Tax Exemption is Scheduled to Collapse in 2026
Effective 2026, the estate tax exemption is scheduled to collapse to an estimated $6.8 million.

The Solution –Estate Planning Strategies as 2026 Estate Tax Exemption Collapse Approaches
Life insurance can be a powerful estate planning tool, as life insurance proceeds are tax-free to beneficiaries. Unfortunately, per Section 2042 of the Internal Revenue Code, a decedent’s estate includes the value of life insurance proceeds. Without careful planning, life insurance proceeds can create expensive estate taxes. With careful planning, life insurance proceeds can be excluded from your taxable estate **– a tax dream**.

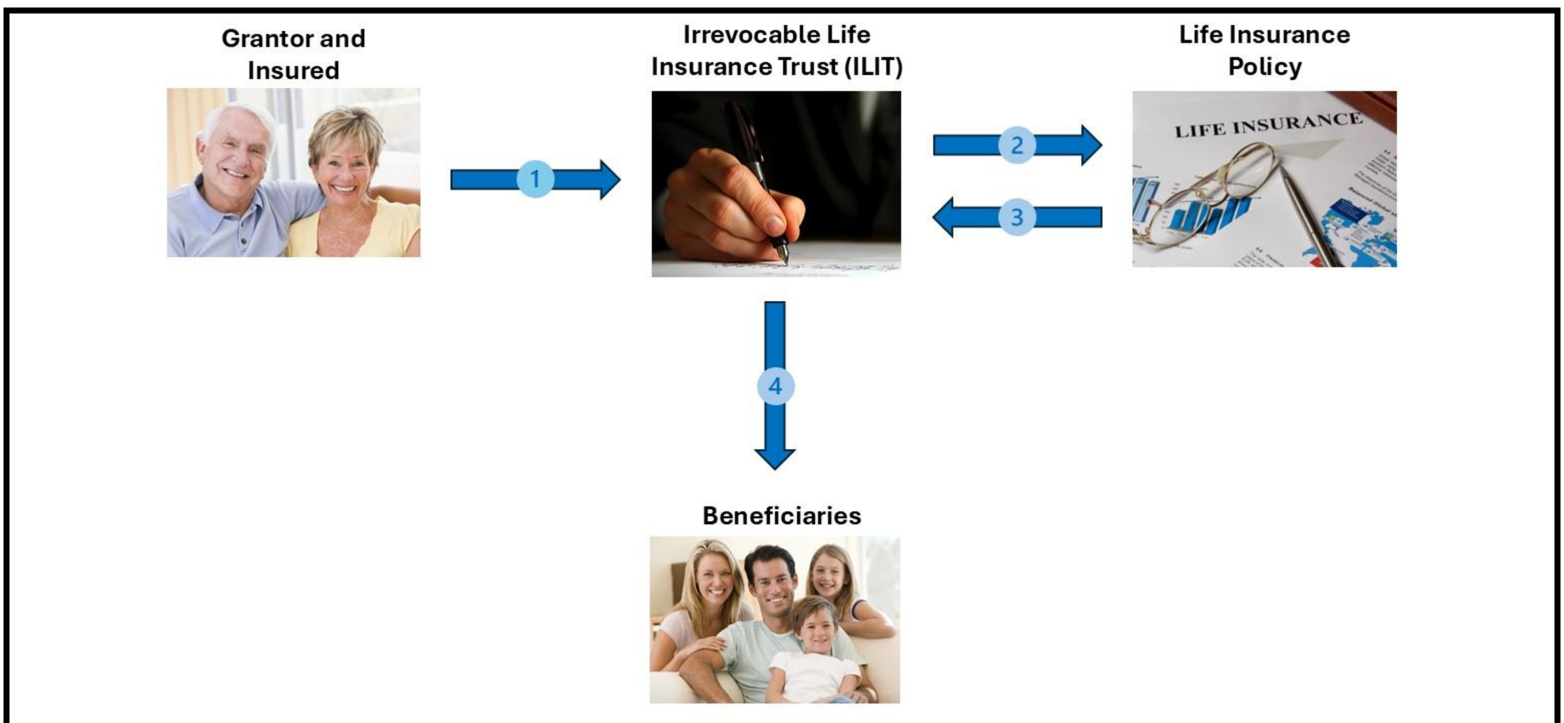
Irrevocable Lie Insurance Trust (ILIT). Through an Irrevocable Life Insurance Trust (ILIT), life insurance proceeds can be excluded from your estate. Once the ILIT is created, you (Grantor) place a life insurance policy that insures you (Insured) into the trust for a group of beneficiaries. You make gifts to the ILIT each year, so the ILIT can pay the premiums on the policy the ILIT owns. When you die (Decedent), the life insurance company pays the tax-free life insurance proceeds to the trust. Then, the trust pays the tax-free life insurance proceeds to the trust’s beneficiaries. Neither the estate, nor the trust, nor the trust’s beneficiaries pay taxes **– a tax dream**. Let’s look at the detailed flow of the ILIT.

Step 1. You (Grantor and Insured) gift an amount equal to the life insurance premium to the ILIT. Per the IRS, the beneficiaries are deemed to have received a gift. For the gift to be tax-free to the beneficiaries, the amount you gifted must qualify as a present gift. The IRS classifies a present gift as one that the beneficiaries have a present interest in the gift and an unrestricted right to the gift. **To accomplish the benefits of the ILIT described above, a Crummey Letter is needed.** A Crummey Letter is sent to the beneficiaries notifying them of their right the withdrawn their gift (“Crummey Power”). If the beneficiaries do not exercise their right, frequently within 30 days, they forfeit their right. In 2024, you can gift up to $18,000 per beneficiary without utilizing your lifetime gift tax exemption. See the table below.

Step 2. Upon forfeiture, the ILIT can pay the life insurance premium. See the table below.

Step 3. Upon your death, the life insurance policy pays the tax-free proceeds to the ILIT. See the table below.

Step 4. The ILIT pays the tax-free proceeds to the beneficiaries - **a tax dream**. See the table below.



Action Steps
Work closely with your Registered Investment Adviser (RIA) to reduce your taxes, and grow and preserve your wealth.

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